



October 12, 2017

Ms. Toni Lee-Andrews  
Ethics Team  
AICPA  
220 Leigh Farm Road  
Durham, NC 27707

**Re: July 7, 2017 PEEC Exposure Draft (ED), *Proposed Interpretation and Other Guidance: State and Local Government Entities (formerly Entities Included in State and Local Government Financial Statements)***

Dear Ms. Lee-Andrews:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to speak on behalf of local and regional firms and represent those firms' interests on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective.

TIC has reviewed the *Proposed Interpretation and Other Guidance: State and Local Government Entities (formerly Entities Included in State and Local Government Financial Statements)* (ED) and is providing the following comments for your consideration.

#### **GENERAL COMMENTS**

TIC appreciated the efforts of PEEC to uphold and improve the code of professional conduct. However, recent exposure drafts issued by PEEC appear to be more rules based and go above the intent of the current threats and safeguard approach included in professional standards. In that regard, TIC has concerns about the additional requirements introduced in this proposed interpretation.

TIC believes the changes proposed in the ED will cause a significant amount of evaluation and documentation based on presumptions of threats, and likely will have the same end result we have today following the current ethics rules and guidance. Essentially, the ED creates additional rules instead of moving away from them, which has been TIC's main concern with several recently issued PEEC proposals, most recently with the *Long Association of Senior Personnel with an Attest Client* Exposure Draft.

Select TIC members who have years of experience with audits of governmental entities have read the proposal, listened to the September webcast, and even spoken to members on PEEC, and TIC

continues to be uncertain as to what was wrong with the existing guidance to perpetuate a potential change. TIC understood this project began because PEEC was interested in evaluating whether the affiliates standard would apply to governments. The evaluation concluded that governments are very different and that it would not apply. TIC concurs with this assessment.

Where TIC differs in opinion is the notion that something had to change with extant on the matter. While affiliates were addressed recently for commercial entities, the governmental version of affiliates (opinion units and component units, for example) was addressed when GASB Statement No. 34, *Basic Financial Statements —And Management’s Discussion and Analysis— For State and Local Governments*, created changes in practice. In the webcast, task force members stated that it had been 17 years since extant was drafted and to paraphrase “so much has changed.” In reality, the standards related to the governmental equivalents to affiliates has not changed. This ED requires a substantial amount of evaluation and documentation that was not required under extant.

In addition, TIC members do not believe the substantial change in evaluation and documentation would change the current outcomes that we achieve with extant. Therefore, TIC feels that the concept of cost benefit has not been satisfied with this ED and TIC would urge PEEC to reconsider these proposed changes.

TIC’s recommendation would be to leave the existing (extant) guidance as it is currently written, but add the elements of paragraph 10 as proposed in the ED that are not currently addressed in extant. This might read as follows:

For funds, component units, or activities included a financial statement for which the member opines, members should apply the “Conceptual Framework for Independence” interpretation [ET sec. 1.210.010] if the member knows or has reason to believe that a relationship or circumstance exists with the entity that would create threats to independence.

TIC believes that most firms are doing the above evaluation today. The task force members on the webinar also stated that the task force shared this belief. Including it with extant would cover the potential issues PEEC and its task force seem to be concerned about without the substantial added burden of required evaluations and rebuttals to presumptions proposed in the ED. One would argue if the member is unaware of the threat of independence, it is unlikely that independence is actually threatened.

### **SPECIFIC COMMENTS**

**Question 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.*

TIC does not understand why PEEC is singling out the general fund in this question as opposed to all governmental funds. However, TIC does believe the framework TIC proposed above will reach an appropriate answer and many times auditors are already reaching these same conclusions in practice today without having a detailed interpretation to get there.

**Question 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?*

TIC has no recommendations related to any additional terms or concepts that PEEC should highlight as an example or consider adding for additional application guidance.

**Question 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?*

TIC believes the term primary government should not be used if the definition is different from what is currently used in GAAP. Instead, TIC would suggest use of the terminology “Upstream Financial Reporting Entity” as described in the ED since that term is not currently used in the accounting standards and will result in less confusion for practitioners.

**Question 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.*

TIC believes that a lot of this information is readily available to the auditor as a result of other audit procedures already being performed today. However, TIC disagrees with the presumption that primary governments have more than minimal influence concept. TIC strongly believes that this presumption is flawed and should be excluded. Additionally, TIC is struggling to tie the potential for independence issues to more than minimal influence. The connection is not clear to TIC and not described adequately in the ED nor in the September webinar. There could be instances where the primary government does not have more than minimal control and an independence issue could exist, that would be covered by paragraph 10 where TIC believes upstream in general should be covered by that paragraph, as noted earlier in this letter.

**Question 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?*

TIC thinks that in the context of the proposed guidance, that objective is clear; however, TIC does not agree that this evaluation is necessary.

**Question 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?*

TIC does not believe the best efforts provision is necessary here. Under the GASB standards, investments are required to be on the governmental entity’s financial statements so it is likely that auditors will be able to get all this information.

TIC believes the upstream provisions, if not eliminated, should include a best efforts provision. Also, TIC believes that PEEC should consider best efforts for determining materiality of entities that are excluded from the financial statements.

**Question 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.*

TIC does believe this ED is clear that the interpretation does not apply to an entity that provides grant funds to the financial statement attest client unless that entity is a fund or component unit that would otherwise be covered by the interpretation.

#### **ADDITIONAL COMMENTS**

As it relates to making reference to the work of other auditors, PEEC believes that making reference to another auditor’s report will not always reduce threats to an acceptable level if the primary government has more than minimal influence over the accounting or financial reporting process of the fund or component unit. This proposal will require an analysis (that likely should be documented) in every case. TIC members questioned if there had been audit failures or significant independence issues in a government financial statement when making reference to another auditor to prompt a change from extant. Rather than requiring the analysis in every case, TIC would suggest PEEC include language in paragraph 10 of the ED to address any potential

concerns as noted previously in this letter. TIC considered this alternative in real examples and came to the conclusion that the language proposed above would address the concern.

In addition, if this ED is approved as drafted, TIC believes that additional time will be needed for firms to update all of their internal policies and procedures to reflect these additional requirements and to ensure compliance with any additional peer review requirements which would likely result after issuance of this interpretation. Therefore, TIC believes that even a proposed effective date of June 15, 2019 may be too soon to ensure that firms of all sizes are able to put the proper controls in place to ensure compliance with this interpretation.

TIC would also encourage PEEC to work with the Peer Review Board to try to ensure that this interpretation is not going to result in any additional documentation requirements or have other unintended consequences for firms that undergo peer review.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

A handwritten signature in black ink that reads "Michael A. Westervelt". The signature is written in a cursive, slightly slanted style.

Michael A. Westervelt, Chair  
PCPS Technical Issues Committee  
cc: PCPS Executive and Technical Issues Committees