



March 11, 2019

Mr. Samuel Burke
Professional Ethics Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Burke:

On behalf of the National State Auditors Association, we appreciate the opportunity to respond to the AICPA's Professional Ethics Executive Committee's exposure draft, *State and Local Government Client Affiliates (formerly Entities Included in State and Local Government Financial Statements)*. We generally agree with the proposed interpretation and other guidance.

Our responses to the specific questions posed in the exposure draft, and some additional comments, follow.

1. Are the examples of circumstances or relationships with nonaffiliates that could result in the member consulting the "Conceptual Framework for Independence" helpful to assessing when the conceptual framework may be applicable? If not, please provide other suggested examples or circumstances that should be included.

We believe the examples identified in paragraph .06 of the exposure draft will be helpful in determining when to consult the "Conceptual Framework for Independence." However, we are concerned that the specificity of the examples may lead to the member interpreting them as a checklist and therefore, limit their scope when considering threats to independence. To alleviate this, we suggest the PEEC clarify that the list is not all inclusive and professional judgment may be needed in other situations.

Additionally, while we appreciate the PEEC's efforts to take into consideration the cost/benefit of complying with this new requirement for certain upstream entities, we found it unclear as to when the user is required to look upstream for threats, as there is limited guidance about these entities beyond the examples provided. In addition, we believe it would be helpful if a definition of nonaffiliate were included.

One additional example that could be added is when a covered member is involved in employment negotiations with the nonaffiliate.

2. Does this exposure draft provide clear guidance to the member on how to determine which entities are affiliates to the financial statement attest client? If not, please explain what areas in this exposure draft are unclear.

We agree the exposure draft provides clear guidance except for entities disclosed in the notes to the financial statements but not included in the financial reporting entity, such as related organizations disclosed pursuant to GASB Statement No. 14, paragraph 68. The definition of affiliates in paragraph .03 refers to entities included or excluded from the financial statements. Further, the definition of financial statements in ET sec. 0.400.17 includes accompanying disclosures. Therefore, it appears related organizations may be affiliates. However, we believe that entities not included in the financial reporting entity should be nonaffiliates. We suggest the

PEEC clarify in paragraph .03 whether entities disclosed in notes to financial statements but not included in the financial reporting entity are affiliates or nonaffiliates. If they are nonaffiliates, the PEEC should consider adding an example for a related organization to paragraph .06.

3. Is it clear that investments will only be considered an affiliate if they are held by the financial statement attest client or by an affiliate under item a.i. of paragraph .03? If not, please provide a suggested clarification on how to make it clear that investments of these two entities only will be considered an affiliate.

Yes, with the exception of paragraph .03.c.iv. This paragraph is not clear because it refers to the term *entity* as broadly defined by paragraph 3.b, instead of a specific type of entity described in paragraph 3.a. Paragraph .03.c.iv was added after the 2017 exposure draft, but we are uncertain as to what it is attempting to further explain for investments. We suggest that the PEEC further clarify this statement by describing or referring to a specific type of entity described in paragraph .03 or remove it altogether.

4. What implementation guidance do you believe would be helpful for the Ethics Division to develop so that the interpretation can be successfully implemented?

In general, we suggest the PEEC include visual aids (such as those from the original exposure draft). In addition, real world examples, expressed in a Q&A format or flowchart format would be helpful.

We have the following specific suggestions for implementation guidance:

- Add illustrations similar to those in the initial ED for paragraph .06.a and .06.c to differentiate among the financial attest client, an affiliate, and the nonaffiliate.
- Add illustrations that describe the different investment scenarios (such as table C from the original exposure draft).

We also have some additional comments below that we believe the PEEC should consider as it finalizes this document.

- Paragraph .02 – The last sentence in this paragraph refers to “the individual”; however, it is not clear if “the individual” is referring to the covered member or the officials. We believe that it should be the officials and recommend the PEEC change “the individual” to “those officials”.
- Paragraph .03.a.iv.1 – Although the term “trivial and clearly inconsequential” in this paragraph is an improvement from the term “de minimis” used in the previous exposure draft, “trivial and clearly inconsequential” is not the exact term found in AU-C 450. AU-C 450 uses and defines the term “clearly trivial” for evaluating misstatements, and the term “clearly inconsequential” to further define the term “clearly trivial.” Therefore, to be consistent with AU-C 450, we suggest that the PEEC reword paragraph .03.a.iv.1. to read, “is not **clearly** trivial and ~~clearly inconsequential~~ to the investor’s financial statements as a whole...”
- Paragraph .03.d – We suggest this paragraph be amended as follows: “State and local government entities are entities whose generally accepted accounting principles standard setter is GASB. Examples of state and local government entities include general purpose governments **and special purpose governments. Examples of general purpose governments include** ~~such as~~ states, counties, cities, towns, **and** villages, ~~and special purpose governments that perform limited activities.~~ Examples of special purpose governments include cemetery districts...”
- Paragraph .06.b uses the term “member” instead of the term “covered member” like the other examples in paragraph .06. We suggest the PEEC reevaluate whether “member” is the appropriate term in paragraph .06.b.

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- Paragraph .08.c – We suggest the paragraph be amended as follows: “Obtains written assurance from **those charged with governance** at the financial statement attest client that it is unable to provide the member...” While this might appear obvious, given the language in paragraph .08.a, this change would be appropriate to avoid having discussions with one party and then obtaining the written assurance from another party.

We appreciate the opportunity to respond to such an important document. Should you have any questions or need additional information regarding our response, please contact Sherri Rowland of NSAA at (859) 276-1147 or me at (919) 807-7500.

Sincerely,

A handwritten signature in black ink that reads "Beth A. Wood". The signature is written in a cursive, flowing style.

Beth Wood
President, NSAA