October 10, 2017

Mr. Samuel L. Burke, Chair  
AICPA Professional Ethics Executive Committee  
1611 Avenue of the Americas  
New York, NY 10017  
Ethics-ExposureDraft@aicpa-cima.com

Re: Proposed Interpretation and Other Guidance - State and Local Government Entities  
(Formerly Entities included in State and Local Government Financial Statements)

Dear Mr. Burke:

We appreciate the opportunity to offer comments on the Proposed Interpretation and Other Guidance - State and Local Government Entities [“the Interpretation”].

The National Association of State Boards of Accountancy’s (NASBA) mission is to enhance the effectiveness and advance the common interests of the Boards of Accountancy that regulate all Certified Public Accountants and their firms in the United States and its territories.

NASBA believes that maintaining auditor independence is a core principal to protecting the public interest. We also appreciate the uniqueness of the GASB financial reporting model for state and local governments compared to the FASB reporting model and the considerations that auditors should make when determining if they are in fact independent.

However, we are not aware of any significant disciplinary actions taken by State Boards regarding independence matters identified related to auditors of primary governments, funds or component units. The interpretation is written in a way that is difficult to understand for both practitioners and regulators and, in some cases, may be difficult to implement and regulate. Although we believe that standards should be principles-based versus rules-based, there should be clear guidance as to the terminology used to facilitate a clear understanding of the basic intent of the standard. If the PEEC continues to move forward with this interpretation, our comments below are made to highlight areas where we believe the guidance could be improved in order to reduce confusion in applying the concepts of the Interpretation.

We offer the following comments on the Interpretation:
Use of Terminology

“Primary government” is defined in GASB Codification Section 2100.112. The Interpretation uses a broader definition of “primary government” than the GASB GAAP definition (GAAP for governments). In GAAP, there can be only one primary government, while application of the Interpretation may result in the determination of more than one primary government when applying the definition upstream. The Interpretation also uses, but does not define, the term “financial reporting entity,” which is defined in GASB Codification Section 2100.111. Financial reporting entity as used in the Interpretation is not consistent with the GASB’s definition. Using definitions different from the GASB’s definitions of these critical terms can lead to misinterpretation and misapplication of the guidance by practitioners. We recommend the GASB’s definition of these terms be applied and the Interpretation be revised accordingly.

More than Minimal Influence

Paragraph .14 states that there is a “rebuttable presumption that the primary government has more than minimal influence over the accounting or financial reporting of a fund or component unit.” The paragraph further provides a list of factors that auditors can consider to demonstrate that the primary government has only minimal influence. We believe that providing guidance on factors that demonstrate only minimal influence is helpful to auditors and appropriate to include in the Interpretation. However, as pointed out in Paragraph .15, it cannot be assumed that a primary government will always have more than minimal influence over all funds and component units. While the primary government will generally be considered to have more than minimal influence over funds, it is less likely for component units. Where component units of the primary government have historically been audited by other auditors, the nature of these entities is often such that they are autonomous in operations and financial reporting, thereby allowing them to be audited by other auditors. Documentation of the auditor’s professional judgment in concluding on the evaluation of influence will be critical to complying with this section of the interpretation.

Materiality

Multiple references in the Explanation and Interpretation are made to “funds and component units that are material to the financial reporting entity.” Guidance is provided that materiality should be considered in relation to the financial reporting entity, rather than in relation to the opinion unit. However, further guidance related to what is considered “material” is not specified. Because materiality is a matter of professional judgment, it is possible that the auditor of the financial reporting entity may reach a different determination than the auditor of the component unit or fund. This will likely create significant challenges for auditors as there will probably be many different auditors reporting on funds and component units of primary governments.

De minimis

Paragraph .11 uses “de minimis” as a criteria for applying the Independence Rule when evaluating attest client’s controlling investments. The term “de minimis” is no longer included in the AICPA
auditing standards and is not part of the existing AICPA Code of Professional Conduct. As stated earlier, we support consistent definitions to avoid misinterpretations. Consequently, we recommend replacing “de minimis” with the updated term “clearly trivial” as defined in AU-C 450.A2.

Effective Date

We agree that significant time will be needed to evaluate and execute any changes necessary. However, situations where auditors conclude they are no longer independent should be addressed immediately. We don’t believe auditors should be permitted to choose whether or not to implement early.

Again, we appreciate the opportunity to comment on the proposed Interpretation.

Sincerely,

Telford A. Lodden, CPA
NASBA Chair

Ken L. Bishop
NASBA President and CEO