February 26, 2019

Professional Ethics Executive Committee
c/o Toni Lee-Andrews, Director
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Via e-mail: Ethics-ExposureDraft@aicpa-cima.com

Re: State and Local Government Client Affiliates

Dear Members and Staff of the AICPA Professional Ethics Executive Committee (PEEC):

The National Association of State Boards of Accountancy (NASBA) appreciates the opportunity to comment on the above-referenced Exposure Draft, State and Local Government Client Affiliates (the Exposure Draft). NASBA’s mission is to enhance the effectiveness and advance the common interests of State Boards of Accountancy (State Boards) that regulate all Certified Public Accountants (CPAs) and their firms in the United States and its territories, which includes all audit, attest and other services provided by CPAs. State Boards are charged by law with protecting the public.

NASBA has been encouraging the State Boards to adopt the AICPA Code of Professional Conduct (the Code) with the goal of having consistent uniform standards in all jurisdictions. Accordingly, we are keenly focused on proposed changes to the Code that might be unacceptable to the State Boards because they are not considered to be in the public interest.

In furtherance of these objectives, NASBA offers the following comments and responses to the Request for Specific Comments.

GENERAL COMMENTS

We generally agree with the proposed interpretation of the Code’s Affiliates, Including State and Local Government Affiliates (1.224.020), which would clarify the affiliates of state and local government units that should be taken into consideration when evaluating threats to independence. We also offer the following responses to the questions posed in the Exposure Draft.
Request for Specific Comments

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.

   Yes, NASBA believes the added examples will help CPAs assess when the CPA may need to apply the conceptual framework.

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.

   NASBA believes the guidance is generally clearer than in the first exposure draft, however, portions of the proposed interpretation may need additional clarification. For example, par. 03(iii) may be confusing to the CPA or state regulator. That is, the guidance states (in part) that, “a material excluded entity is an entity that is required under the applicable financial reporting framework to be included in the financial statements of the financial statement attest client but is, nevertheless, excluded by the financial statement attest client ....” It would be useful to provide an example of when this may occur.

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.

   NASBA believes paragraph .03(c) in the statement could use additional clarification, perhaps by further emphasizing the reference to .03(a)(i), for example –

   “An investment is a security or other asset that the financial statement attest client, or an affiliate as defined in Terminology, par. 03(a)(i), holds primarily for the purpose of income or profit and has present service capacity based on solely on its ability to generate cash or to be sold to generate cash…”

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

   NASBA believes guidance that clarifies the purpose and application of this interpretation and provides visual displays (e.g., flow charts for different scenarios) illustrating the required thought process would be quite helpful to practitioners as they prepare to implement the revised interpretation.
Other Comments-

- The term “financial reporting entity” is used in paragraph .09 but is not defined in the Code of Professional Conduct or in this Interpretation. As the Governmental Accounting Standards Board (GASB) has a unique industry-specific definition for “financial reporting entity,” it is unclear as to whether practitioners are expected to apply the GASB definition, some other Interpretation-specific definition, or whether the term is more appropriately replaced with “financial statement attest client.”

- We believe further clarification is necessary related to the application of materiality in paragraph .11 and have provided suggested edits below:

**Material to the Financial Statements as a Whole**

_Determination of materiality is a matter of professional judgment. Members should consider both quantitative and qualitative factors when determining whether an entity or investment is material to the financial statements. For purposes of paragraphs 03a.ii and 03a.iii, materiality is intended to be applied at the financial statement attest client’s financial statements as a whole, rather than individual opinion units in circumstances in which there may be more than one opinion unit. For purposes of paragraph 03a.iv., materiality is intended to be applied to the investor’s financial statements as a whole rather than individual opinion units in circumstances in which there may be more than one opinion unit._

Again, we appreciate the opportunity to comment on the Exposure Draft.

Very truly yours,

Janice L. Gray, CPA, CVA  
NASBA Chair

Ken L. Bishop  
NASBA President and CEO