

## THE PPC

## GOVERNMENTAL UPDATE

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## AICPA Issues Implementation Guide—State and Local Government Client Affiliates



In June of 2019, the AICPA issued revised ethics interpretation *State and Local Government Client Affiliates* (ET 1.224.020) (the interpretation). The **August 2019 issue** of this newsletter included a detailed article about the interpretation, but a brief recap of the interpretation is provided below. The effective date of the interpretation, as amended, is for years beginning after December 15, 2021.

In October 2020, as a follow-up to the interpretation, the AICPA issued *Implementation Guide—State and Local Government Client Affiliates* (the implementation guide) which is the subject of this article.

### Brief Recap of the Interpretation

The interpretation requires an auditor to determine whether they are independent from an affiliate of their state and local government financial statement attest client (FSAC). In addition, the interpretation refers the auditor to the *Conceptual Framework for Independence* when they encounter threats to independence and provides examples of those threats. It also discusses nonattest services provided to an affiliate and introduces the concept of

*minimal influence* in determining whether an entity meets the definition of affiliate. Finally, the interpretation discusses the auditor's responsibility to identify affiliates and provides steps to take if the auditor is unable to obtain information to identify affiliates.

### Introduction to the Implementation Guide

With that background in mind, let's discuss the implementation guide. The main purpose of the implementation guide is to help auditors understand which entities are affiliates of their FSACs. An *affiliate* is an entity requiring independence, including those that the applicable reporting framework requires to be included in the FSAC's financial statements, even though they may be excluded.

### Contents of the Implementation Guide

The implementation guide contains several tools to assist the auditor, such as decision trees, an interactive Excel template, exhibits, examples, and survey tools or "calculators" for entities and investments. Let's discuss a few of those items in more detail.

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*Affiliate decision trees.* There are two decision trees provided in the implementation guide—one relates to entities your FSAC is required to include in its financial statements and one relates to investments. The decision trees are very clear, color coded, and include pathways.

*Pathways.* There are three “pathways” within the decision trees where an affiliate relationship may exist:

- *Inclusion pathway.* Entities included in the financial statements of your FSAC. Within this pathway are two scenarios, one in which your audit report does not reference another auditor and one in which your audit report does.
- *Exclusion pathway.* Entities *not* included in the financial statements of your FSAC. This results in a departure from the applicable reporting framework because, although the framework requires the entity be included in the FSAC’s financial statements, it is excluded.
- *Investment pathways.* These pathways are concerned with investments of your FSAC or an affiliate of your FSAC. Here you look to whether the FSAC has either *control* or *significant influence* over the investee. In addition, you will consider whether the investment is trivial and clearly inconsequential to the FSAC’s financial statements as a whole.

*More than minimal influence.* The implementation guide includes a discussion on what is meant by *more than minimal influence*. In general, auditors need to assess the level of influence that an FSAC has on an entity’s accounting or financial reporting process. Two key factors to consider in your assessment are: 1) whether the included entity uses the same accounting system that your FSAC uses or 2) whether your FSAC shares accounting staff with the included entity.

*Nonattest services exception.* The implementation guide includes a discussion on the nonattest services exception. Regarding an FSAC auditor providing prohibited nonattest services to an affiliate, there is an exception to applying the independence rules to the affiliate. Under the exception, the FSAC auditor may not be prohibited from providing these services when the following apply:

- You can reasonably conclude that the prohibited nonattest service does not create a self-review threat, because the results of the service will not be subject to attest procedures.
- Any other threats created by providing the nonattest service can be eliminated or reduced to an acceptable level by the application of safeguards.

*Note:* Keep in mind that the nonattest services exception only applies to affiliates defined in paragraph .03aii-iii of the interpretation (generally, an entity included in the FSAC’s financial statements when the member makes reference to another auditor’s report, the entity is material to the financial statements of the FSAC as a whole, and the FSAC has more than minimal influence over the

entity’s accounting or financial reporting). It does not apply to affiliates defined in paragraph .03ai (generally an entity included in an FSAC’s financials when the member is not making reference to another auditor’s report) or .03aiv of the interpretation (a material investment in which the investor controls and has significant influence over the investee).

## Actions for Auditors to Consider Now

With the implementation guide available, auditors should consider taking steps now to consider the impact of the interpretation on their FSACs. Though the interpretation will first be applicable for December 2022 year ends, independence will be assessed from the beginning of the audited period. Thus, these relationships may be an issue as of January 1, 2022.

Specifically, auditors may want to consider whether there are new affiliates under the interpretation that require independence. In addition, there may be circumstances and relationships with existing affiliates that pose a threat to independence. You may even find it necessary to refer to the Conceptual Framework for determining if threats to independence exist. Consider employment relationships, nonattest services provided, and financial interests of FSACs and their affiliates. The implementation guide provides examples of scenarios that will give you an idea on how to apply the Conceptual Framework.

### Practical Consideration:

The following are links to the implementation guide and tools:

- Implementation Guide:  
[www.aicpa.org/content/dam/aicpa/interestareas/professionalethics/resources/downloadabledocuments/toolkitsandaids/implementation-guide-state-and-local-government-client-affiliates.pdf](http://www.aicpa.org/content/dam/aicpa/interestareas/professionalethics/resources/downloadabledocuments/toolkitsandaids/implementation-guide-state-and-local-government-client-affiliates.pdf)
- Interactive Affiliate Matrix:  
[www.aicpa.org/content/dam/aicpa/interestareas/professionalethics/resources/downloadabledocuments/toolkitsandaids/interactive-slg-affiliate-matrix.xltx](http://www.aicpa.org/content/dam/aicpa/interestareas/professionalethics/resources/downloadabledocuments/toolkitsandaids/interactive-slg-affiliate-matrix.xltx)
- Affiliate Calculator for Entities:  
[www.surveymonkey.co.uk/r/Entityaffiliateevaluator](http://www.surveymonkey.co.uk/r/Entityaffiliateevaluator)
- Affiliate Calculator for Investments:  
[www.surveymonkey.co.uk/r/Investmentaffiliateevaluator](http://www.surveymonkey.co.uk/r/Investmentaffiliateevaluator)



# AICPA Issues SAS No. 142 on Audit Evidence

In July 2020, the AICPA issued SAS No. 142, *Audit Evidence*. SAS No. 142 supersedes the current AU-C 500 and moves guidance on the use of management specialists to AU-C 501.

The new SAS aims to improve audit quality in evaluating information used as audit evidence and concluding whether sufficient appropriate audit evidence has been obtained. SAS No. 142 is intended to assist auditors in fulfilling responsibilities included in other AU-C sections and it should be read in conjunction with other AU-C sections.

## What's Included?

While the body of the standard is comprised of only 10 paragraphs, the explanatory and application materials provide extensive new guidance and helpful examples. It doesn't impose any additional specific audit procedures; however, it does expand explanations of the types of evidence available, tools and techniques that may be used to obtain evidence, and how to think about and evaluate the persuasiveness of evidence obtained.

The key areas of change or potential improvement in audit quality covered by SAS No. 142 and amendments related to AU-C sections are as follows:

- **Automated Tools and Techniques.** Audit procedures can be performed either manually or by using automated tools and techniques, and SAS No. 142 provides guidance and many examples of how automated tools and techniques *may* be used. The tools and techniques identified include—
  - audit data analytics (ADA),
  - artificial intelligence,
  - machine learning,
  - remote observation tools (e.g., drones),
  - testing distributed ledgers (e.g., blockchain) in real time,
  - text-recognition programs, and
  - robotic process automation.

These tools can generate useful information that can be used as audit evidence, including risk assessment procedures, substantive procedures, and internal controls evidence.

SAS No. 142 addresses the question of whether ADA may be used to concurrently perform both a risk

assessment procedure and a substantive procedure. Exhibit A illustrates, in case-study format, the use of ADA simultaneously as a risk assessment and a substantive procedure.

- **Corroborative and Contradictory Information.** SAS No. 142 requires the auditor to evaluate information to be used as audit evidence by taking into account whether the information corroborates or contradicts financial statement assertions or financial statement amounts. AU-C 330, as amended by SAS No. 142, explicitly requires that further audit procedures be designed and performed *in a manner that isn't biased towards obtaining evidence that may be corroborative or towards excluding audit evidence that may be contradictory*.
- **Conscious and Unconscious Bias.** SAS No. 142 spotlights the need to consider the susceptibility of information used as audit evidence to management bias, as well as the potential for the auditor's own bias in planning and performing the audit—both in the design of audit procedures and the evaluation of audit evidence. It observes that audit evidence is generally more reliable when it is obtained from external parties, because it is less susceptible to management bias and information with a higher susceptibility to management bias is less reliable unless audit procedures have specifically addressed that bias. AU-C 200, as amended by SAS No. 142, notes that unconscious or conscious auditor biases may affect professional skepticism and professional judgment. It provides examples of unconscious biases, such as tendencies to place more weight on information that is readily available (availability bias) or that corroborates an existing belief (confirmation bias).
- **External Sources of Information.** SAS No. 142 defines an *external information source* as an external individual or organization that provides information used by the entity in preparing financial statements or that has been obtained by the auditor as audit evidence, when such information is suitable for use by a broad range of users. Examples are—
  - media,
  - securities pricing services,
  - governmental organizations,
  - central banks,
  - recognized stock exchanges, and
  - academic journals.

Appendix A, *Considerations Regarding the Use of External Information Sources*, provides guidance on considering the relevance and reliability of this information.

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- **Reliability of Information.** The reliability and quality of information used as audit evidence, from any source, is affected by its accuracy, completeness, authenticity, and susceptibility to management bias. Prior guidance included broad generalizations, such as reliability being increased when obtained from independent sources outside the entity. In contrast, SAS No. 142 points out that consideration of the sources of information to be used as audit evidence includes the possibility that the information source, even an external source, may not be reliable.

## Effective Date

SAS No. 142 is effective for audits of financial statements for periods ending on or after December 15, 2022.

Because of the delayed effective date of SAS No. 142,

auditors have time to consider how to adapt their audit methodology to incorporate the tools and techniques it provides. Audit firms' expanded use of automated tools and techniques, including ADA, can result in more efficient and effective audits and allow for testing of 100% of a population instead of just a sample, in less time to boot. Additionally, firms should consider how their policies and practices on hiring, training, professional development, and allocation of resources may be affected by SAS No. 142.

### Practical Consideration:

SAS No. 142 is available at [www.aicpa.org](http://www.aicpa.org) and on Checkpoint at [checkpoint.riag.com](http://checkpoint.riag.com).

