Introduction

Although the statements and examples in implementation guide State and local government client affiliates (guide) are not rules or interpretations issued by the Professional Ethics Executive Committee (PEEC) and are not considered authoritative guidance, PEEC has reviewed the content and found it to be consistent with the AICPA Code of Professional Conduct (code).

This guide does not address the requirements of other standard setters or regulatory bodies, such as the state boards of accountancy, the SEC, and the U.S. Government Accountability Office, whose positions may differ from those of the AICPA.

In applying the “State and Local Government Client Affiliates” interpretation (ET sec. 1.224.020), you should comply with all applicable interpretations of the “Independence Rule” (ET sec. 1.200.001).

Terms defined in the code are italicized. The first time you see a defined term in a section of the guide, it will link to the code.

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1 You can find all ET sections in the AICPA Code of Professional Conduct.
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The implementation guide: What’s it all about?

The “State and Local Government Client Affiliates” interpretation (ET sec. 1.224.020, referred to in this guide as “the interpretation”) under the “Independence Rule” (ET sec. 1.200.001) provides that members should be independent of certain entities that a state or local government (SLG) financial statement attest client is required to include in its financial statements. For simplicity, the guide refers to an SLG financial statement attest client as an FSAC. The interpretation defines the entities requiring independence as affiliates, including those that the applicable financial reporting framework requires to be included in the FSAC’s financial statements but that are, nevertheless, excluded. The interpretation is effective for periods beginning after December 15, 2021.

How can this guide help you?

This guide will help you understand which entities are affiliates of your FSAC. If you identify an affiliate, you’ll need to be independent of that entity. It can also help you to recognize circumstances or relationships in the SLG environment where you might need to consult the “Conceptual Framework for Independence” (ET sec. 1.210.010).

What’s included in the guide?

- **Decision trees** that give you an overview of the pathways to identify affiliates
- **Descriptions of the pathways** in which an entity or investment would be considered an affiliate
- **Exhibits** that illustrate the decision points along these pathways
- **Keys to understanding more than minimal influence** and how you might determine it
- **Description of the nonattest services exception** within the interpretation
- **Examples of how these pathways could be applied** to XYZ State
- **Examples of circumstances or relationships** where you might need to consult the “Conceptual Framework for Independence”
- **Tools** to help you implement the guidance

Affiliate decision trees

Paragraph .03 of the interpretation includes a detailed definition of an affiliate. To help you translate that definition into actionable decisions, we’ve created two decision trees — one related to entities your FSAC is required to include in its financial statements and one related to investments.
I. Entities that the applicable financial reporting framework requires to be included in your FSAC’s financial statements

The following decision tree will guide you through determining affiliates as defined in paragraph .03ai–iii of the interpretation.

- Is the entity included in the FSAC’S financial statements?
  - Yes
    - Inclusion pathway — Does your audit report make reference to another auditor’s report?
      - Yes
        - Entity is material to the FSAC’S financial statements as a whole?
          - Yes
            - Entity is an affiliate as defined in paragraph .03ai of the interpretation.
          - No
            - Entity not an affiliate.
      - No
        - Entity is an affiliate as defined in paragraph .03aii of the interpretation.
  - No
    - Exclusion pathway — Is the entity material to the FSAC’S financial statements as a whole?
      - Yes
        - Entity is an affiliate as defined in paragraph .03aiii of the interpretation.
      - No
        - Entity not an affiliate.

*The exclusion pathway relates to entities that the applicable financial reporting framework requires to be included in the FSAC’S financial statements but that are, nevertheless, excluded.
II. Investments held by an investor

The following decision tree will guide you through determining affiliates as defined in paragraph .03aiv of the interpretation. In this context, an “investor” includes the FSAC or an affiliate of the FSAC as defined in paragraph .03ai of the interpretation.

Does the investor have control over the investee?

Yes

Is the investment trivial and clearly inconsequential to the investor’s financial statements as a whole?

Yes

Investee is not an affiliate.

No

Investee is an affiliate as defined in paragraph .03aiv(1) of the interpretation.

No

Does the investor have significant influence over the investee?

Yes

Is the investment material to the investor’s financial statements as a whole?

Yes

Investee is an affiliate as defined in paragraph .03aiv(2) of the interpretation.

No

Investee is not an affiliate.

No

Investee is not an affiliate.
Pathways

There are three pathways where an affiliate relationship may exist when you are applying the interpretation. This guide refers to these pathways as follows:

- **Inclusion pathway**
- **Exclusion pathway**
- **Investments**
  - Control pathway
  - Significant influence pathway

### Inclusion pathway

The first pathway relates to included entities — entities that the FSAC includes in its *financial statements*. There are two scenarios you might face in which an included entity would be considered an affiliate of your FSAC and, as a result, you would need to be independent of the included entity in addition to being independent of your FSAC.

1. **Your audit report does not reference another auditor.**

   If you include the entity in your FSAC’s *financial statements* and do not reference another auditor’s report, the included entity is considered the FSAC’s affiliate as defined in paragraph .03ai of the interpretation. If that’s the case, you would need to apply the “Independence Rule” and related interpretations to the included entity.

2. **Your audit report does reference another auditor.**

   An entity will be considered your FSAC’s affiliate as defined in paragraph .03a(ii) of the interpretation if you refer to another auditor’s report on the *financial statements* of the included entity and

   a. the included entity is material to your FSAC’s *financial statements* as a whole and
   b. your FSAC has more than minimal influence over the accounting or financial reporting process of the included entity. (The next section gets into more details about this.)

With one exception, you would need to apply the “Independence Rule” and related interpretations to the included entity when it’s determined to be an affiliate. The exception relates to the provision of certain nonattest services (more to come on this later in the section “Nonattest services exception”).

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2 Refer to the exclusion pathway for entities that the applicable financial reporting framework requires to be included in the FSAC’s *financial statements* but that are, nevertheless, excluded.

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Illustration — The inclusion pathway in action

Let's take a closer look at the inclusion pathway. Exhibit A breaks the pathway down into easy-to-follow steps for determining whether an included entity would be considered an affiliate as defined in paragraph .03ai or paragraph .03aii of the interpretation.

Exhibit A: Inclusion pathway

Don’t stop now...

Keep using the pathway to evaluate entities until, in your professional judgment, you have identified all affiliates. For example, if you’ve followed the pathway and concluded a component unit is an affiliate, you should evaluate that affiliate’s component units as well.

Exclusion pathway

The exclusion pathway relates to entities that the applicable financial reporting framework requires to be included in the FSAC’s financial statements but that are, nevertheless, excluded. This exclusion results in a departure from the applicable financial reporting framework.

Even if an entity is excluded from your FSAC’s financial statements, it still might be considered an affiliate as defined in paragraph .03aiii of the interpretation. This will be the case when

- the excluded entity is material to your FSAC’s financial statements as a whole and
- your FSAC has more than minimal influence over the accounting or financial reporting process of the excluded entity.

If the entity is considered an affiliate, you will need to apply the “Independence Rule” and related interpretations to the excluded entity. However, there is one exception related to the provision of certain nonattest services (see the section "Nonattest services exception" for a detailed discussion).
Illustration — The exclusion pathway in action

Now let’s take a deeper dive into the exclusion pathway. Follow the steps outlined in the exhibit to determine whether the excluded entity would be considered an affiliate of your FSAC as defined in paragraph .03aiii of the interpretation.

Exhibit B: Exclusion pathway

Don’t stop now…

Keep using the pathway to evaluate entities until, in your professional judgment, you have identified all affiliates. For example, if you determine a component unit is an affiliate, you should evaluate the affiliate’s component units as well.
Investment pathways

As the name suggests, these pathways are all about investments. You will only need to evaluate investments of your FSAC or an affiliate of your FSAC as defined under paragraph .03ai of the interpretation. However, you might come across a circumstance or relationship where you need to consider applying the conceptual framework. There are several examples of such situations here.

These pathways take into consideration the relationship between an investor and an investee and how that relationship might affect independence. An investee will be considered an affiliate under paragraph .03aiv of the interpretation if it meets the criteria in either of these pathways:

- **Control investment pathway.** The investor has control over the investee, unless the investment in the investee is trivial and clearly inconsequential to the FSAC’s financial statements as a whole.
- **Significant influence investment pathway.** The investor has significant influence over the investee and the investment in the investee is material to the FSAC’s financial statements as a whole.

When the criteria of either pathway are met, you will need to apply the “Independence Rule” and related interpretations to the investee.

Illustration — The investment pathways in action

What might it look like to apply these criteria? The following exhibits illustrate the step-by-step process of determining whether an investee is an affiliate under paragraph .03aiv of the interpretation.

**Exhibit C.1: Control investment pathway**

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3 For purposes of the interpretation, an investor includes only the FSAC or an affiliate of the FSAC as defined in paragraph .03ai of the interpretation.

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Does your FSAC have more than minimal influence?

There is a rebuttable presumption that when the entity is a fund or blended component unit, the FSAC has more than minimal influence over the entity’s accounting or financial reporting process. How would you go about rebutting that presumption? And how do you determine whether the FSAC has more than minimal influence over the accounting or financial reporting process of an entity included in the FSAC’s financial statements?

The factors in paragraph .09 of the interpretation will help you assess the actual level of influence your FSAC has on the entity’s accounting or financial reporting process. You’ll need to evaluate each factor based on the facts and circumstances in your FSAC’s situation. Certain factors might be more important or less important depending on how they could potentially impair independence. In some cases, a single factor is enough; in others, multiple factors may need to be considered.

Use substantive considerations when evaluating the factors. For example, if your FSAC can exercise influence but hasn’t exercised that ability in the past and doesn’t intend to do so in the future, that factor might be less significant. Ultimately, you will need to rely on your professional judgment to support your conclusion about whether your FSAC has more than minimal influence over the entity’s accounting or financial reporting process.
More than minimal influence scenario

The situation

Your FSAC has an included entity that is audited by another auditor. That included entity is material to your FSAC’s financial statements as a whole and you make reference to the other auditor’s report. To reach a conclusion on whether the included entity is an affiliate of the FSAC, requiring independence, you need to evaluate whether your FSAC has more than minimal influence over the accounting or financial reporting process of the included entity.

The key factors

Here are two important points to consider in this situation:

1. The included entity uses the same accounting system that your FSAC uses.
2. Your FSAC shares certain accounting staff with the included entity.

The conclusion

As a result of your evaluation, you conclude that by sharing accounting staff and using the same accounting software to maintain their books and records, your FSAC appears to have more than minimal influence over the accounting or financial reporting process of the included entity. You might reach a different conclusion if the shared accounting staff was not in a key position at the included entity. Similarly, if the accounting system was significantly customized by the included entity, resulting in a system that operated differently than the system used by your FSAC, your decision might be different. The same evaluation and considerations would apply if the entity had been excluded from the FSAC’s financial statements.

Nonattest services exception

As discussed earlier, when an entity is an affiliate, the interpretation requires you to apply the "Independence Rule" and related interpretations applicable to the FSAC to the affiliate. However, as mentioned before, there is one exception related to the provision of certain nonattest services.

What is the nonattest services exception?

Paragraph .07 of the interpretation provides an exception for prohibited nonattest services. In this context, “prohibited nonattest services” are services that would impair independence under the "Nonattest Services" subtopic (ET sec. 1.295) of the “Independence Rule.”

What does this actually mean? Under the nonattest services exception, you would not be prohibited from providing these services to affiliates of the FSAC 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 nonattest service will not be subject to financial statement 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.

Warning! You may only apply this exception to affiliates defined in paragraph .03aii–iii of the interpretation (see the inclusion and exclusion pathways). This exception does not apply if you're evaluating nonattest services related to an affiliate defined in paragraph .03ai or .03aiv of the interpretation.
Nonattest services exception scenarios

The following scenarios provide hypothetical examples of some situations in which the nonattest services exception might come into play.

Keep these points in mind as you read through the scenarios:

- Firm Z audits ABC County.
- Firm Z determines that County Housing Authority meets the definition of an affiliate under paragraph .03aii of the interpretation.
- Firm Z determines that NFP Company meets the definition of an affiliate under paragraph .03aiii of the interpretation.

Scenario 1: Included entity

The situation

County Housing Authority asks Firm Z to provide backup services for its data and records. Under the “Hosting Services” interpretation (ET sec. 1.295.143) of the “Independence Rule,” Firm Z concludes the services are prohibited hosting services.

The question

Do the otherwise prohibited backup services meet the requirements of the nonattest services exception?

The conclusion

It depends. If Firm Z concludes that the backup services will not be subject to financial statement attest procedures and all other threats are at an acceptable level, then Firm Z can provide the backup services to County Housing Authority without impairing independence.

Scenario 2: Excluded entity

The situation

NFP Company asks Firm Z to perform financial information system design services. Under the “Information Systems Design, Implementation, or Integration” interpretation (ET sec. 1.295.145) of the “Independence Rule,” Firm Z concludes that financial information system design services are prohibited services.

The question

Do the otherwise prohibited financial information system design services meet the requirements of the nonattest services exception?

The conclusion

It depends. If Firm Z concludes that the financial information system design services will not be subject to financial statement attest procedures and all other threats are at an acceptable level, then Firm Z can provide the design services to NFP Company without impairing independence.
Putting it all together: Does your FSAC have any affiliates?

Now that you’ve examined the components of the interpretation relevant to affiliates — the inclusion, exclusion, and investment pathways — it’s time to put it all together.

As you read through the examples, keep this information in mind:

Firm A audits XYZ State, which prepares its financial statements in accordance with generally accepted accounting principles (GAAP). XYZ State has numerous funds and component units. Firm A is determining which entities meet the definition of an affiliate and, as such, require application of the “Independence Rule” and related interpretations. To determine whether they are affiliates, Firm A is evaluating

- Highway Fund, a fund XYZ State includes in its financial statements.
- Public University, a discretely presented component unit XYZ State includes in its financial statements.
- University Foundation, a blended component unit Public University includes in its financial statements.
- Utility District, a discretely presented component unit GAAP requires XYZ State to include in its financial statements but that is excluded (GAAP departure).
- Investments of Public Pension Trust Fund, funds XYZ State includes in its financial statements.
Affiliate under paragraph .03ai — Highway Fund

The situation


The conclusion

Highway Fund is an affiliate of XYZ State as defined in paragraph .03ai of the interpretation because Firm A does not reference Firm B’s audit of the fund.

Firm A should apply the “Independence Rule” and related interpretations to Highway Fund.

In addition, Firm A

- should evaluate investments, if any are held by Highway Fund, to determine if there are any investments that are also affiliates as defined in paragraph .03aiv of the interpretation.
- may not use the nonattest services exception, because the Highway Fund is an affiliate under paragraph .03ai.

The same conclusion would be reached if Firm A audited Highway Fund.

What about Firm B?

Because Firm B’s FSAC is Highway Fund, Firm B should determine the affiliates of Highway Fund by evaluating

- entities that the applicable financial reporting framework requires Highway Fund to include in its financial statements.
- investments held by Highway Fund and affiliates of Highway Fund that meet the definition in paragraph .03ai of the interpretation.
Affiliate under paragraph .03a(ii) — Public University

The situation

XYZ State includes Public University in its financial statements as a material discretely presented component unit. Firm C audits Public University. Firm A references Firm C’s audit report in Firm A’s audit report on XYZ State’s financial statements. XYZ State has more than minimal influence over Public University’s accounting or financial reporting process.

The conclusion

Public University is an affiliate of XYZ State as defined in paragraph .03a(ii) of the interpretation because

- Public University is material to XYZ State’s financial statements as a whole and
- XYZ State has more than minimal influence over Public University’s accounting or financial reporting process.

Firm A should apply the “Independence Rule” and related interpretations to Public University.

In addition, Firm A

- does not need to evaluate investments held by Public University for independence purposes.
- may use the nonattest services exception.

If Public University was not material to XYZ’s financial statements as a whole, then Public University would not be considered an affiliate of XYZ State as defined in paragraph .03a(ii) of the interpretation. Similarly, if XYZ State did not have more than minimal influence over Public University’s accounting or financial reporting process, Public University would not be considered an affiliate of XYZ State.

What about Firm C?

Because Firm C’s FSAC is Public University, Firm C should determine the affiliates of Public University by evaluating

- entities that the applicable financial reporting framework requires Public University to include in its financial statements.
- investments held by Public University and affiliates of Public University, as defined in paragraph .03a(i) of the interpretation.

Exhibit D.1 provides a visual of the conclusion that Public University is an affiliate of XYZ State under paragraph .03a(ii) of the interpretation.

Exhibit D.1: par. .03a(ii) example
Affiliate under paragraph .03a(ii) — University Foundation

The situation

University Foundation is a blended component unit of Public University, which the university includes in its financial statements. Public University is a discretely presented component unit of XYZ State. University Foundation is also included in XYZ State’s financial statements and is material to XYZ State. Firm C audits University Foundation. Firm A references Firm C’s audit report in the auditor’s report on XYZ State’s financial statements. XYZ State has more than minimal influence over University Foundation’s accounting or financial reporting process.

The conclusion

University Foundation is an affiliate of XYZ State as defined in paragraph .03a(ii) of the interpretation because

- University Foundation is material to XYZ State’s financial statements as a whole and
- XYZ State has more than minimal influence over University Foundation’s accounting or financial reporting process.

Firm A should apply the “Independence Rule” and related interpretations to University Foundation.

In addition, Firm A

- does not need to evaluate investments held by University Foundation for independence purposes.
- may use the nonattest services exception.

If University Foundation was not material to XYZ’s financial statements as a whole, then University Foundation would not be an affiliate of XYZ State as defined in paragraph .03a(ii) of the interpretation. Similarly, if XYZ State did not have more than minimal influence over University Foundation’s accounting or financial reporting process, University Foundation would not be an affiliate of XYZ State.

Exhibit D.2 provides a visual of the conclusion that University Foundation is an affiliate of XYZ State under paragraph .03a(ii) of the interpretation.

Exhibit D.2: par. .03a(ii) example
Affiliate under paragraph .03aiii — Utility District

The situation

Utility District is material to XYZ State and should be presented as a discretely presented component unit under the applicable financial reporting framework (in this case, GAAP). Although GAAP requires XYZ State to include Utility District in its financial statements, XYZ State departs from GAAP and excludes Utility District because Utility District does not have current audited financial statements available. XYZ State has more than minimal influence over Utility District’s accounting or financial reporting process.

The conclusion

Utility District is an affiliate of XYZ State as defined in paragraph .03aiii of the interpretation because

- Utility District is material to XYZ State’s financial statements as a whole and
- XYZ State has more than minimal influence over Utility District’s accounting or financial reporting process.

Firm A should apply the “Independence Rule” and related interpretations to Utility District.

In addition, Firm A

- does not need to evaluate investments held by Utility District for independence purposes.
- may use the nonattest services exception.

If Utility District was not material to XYZ’s financial statements as a whole, then Utility District would not be an affiliate of XYZ State as defined in paragraph .03aiii of the interpretation. Similarly, if XYZ State did not have more than minimal influence over Utility District’s accounting or financial reporting process, Utility District would not be an affiliate of XYZ State.

Exhibit D.3 provides a visual of the conclusion that Utility District is an affiliate of XYZ State under paragraph .03aiii of the interpretation.

Exhibit D.3: par. .03aii example
The situation

XYZ State includes Public Pension Trust Fund, which it reports as a fiduciary fund, in its financial statements. Firm A determines that Public Pension Trust Fund is an affiliate of XYZ State as defined in paragraph .03ai of the interpretation. As a result, Firm A will need to evaluate Public Pension Trust Fund’s investments to determine if there are any investees that are also affiliates as defined in paragraph .03aiv of the interpretation.

The following examples illustrate Firm A’s evaluation of two investments of Public Pension Trust Fund, in DEF Company and RST Company, to determine if either investment would be an affiliate of XYZ State.

Investment in DEF Company

Public Pension Trust Fund is considered an investor as defined in the interpretation because Public Pension Trust Fund is an affiliate of XYZ State under paragraph .03ai of the interpretation. Public Pension Trust Fund has a controlling interest in DEF Company, and the trust fund’s investment in DEF Company is more than trivial and is clearly consequential to XYZ State’s financial statements as a whole.

The conclusion

DEF Company is an affiliate of XYZ State as defined in paragraph .03aiv(1) of the interpretation because

- Public Pension Trust Fund’s ownership interest in DEF Company gives it control over DEF Company and
- Public Pension Trust Fund’s investment in DEF Company is more than trivial and is clearly consequential to XYZ State’s financial statements as a whole.

Firm A should apply the “Independence Rule” and related interpretations to DEF Company.

If DEF Company had an investment in TUV Company, Firm A would not need to evaluate the investment in TUV Company because DEF Company is not considered an investor as defined in the interpretation. The evaluation ceases with the original investment as indicated in paragraph .03c of the interpretation.

In addition, Firm A may not use the nonattest services exception.

If Public Pension Trust Fund’s investment in DEF Company was trivial and clearly inconsequential to XYZ State’s financial statements as a whole, DEF Company would not be an affiliate of XYZ State.

If, however, Public Pension Trust Fund’s investment in DEF Company was more than trivial and was clearly consequential to XYZ State’s financial statements as a whole, but Public Pension Trust Fund did not have control over DEF Company, Firm A would need to continue its evaluation and determine whether DEF Company is an affiliate using the significant influence investment pathway. (The next example demonstrates the significant influence investment pathway using the investment in RST Company.)
Exhibit D.4.1 provides a visual of the conclusion that DEF Company is an affiliate of XYZ State under paragraph .03aiv(1) of the interpretation.

Exhibit D.4.1: par. .03aiv(1) example

Yes

Does Public Pension Trust Fund have control over DEF Company?

No

Is the investment in DEF Company trivial and clearly inconsequential to XYZ State’s financial statements as a whole?

DEF Company is an affiliate (par. .03aiv(1) of the interpretation).
Investment in RST Company

Public Pension Trust Fund is considered an investor as defined in the interpretation. Public Pension Trust Fund also has an interest in RST Company that gives the trust fund significant influence over RST Company. The investment in RST Company is material to XYZ State’s financial statements as a whole.

The conclusion

RST Company is an affiliate of XYZ State as defined in paragraph .03aiv(2) of the interpretation because

- Public Pension Trust Fund’s ownership interest in RST Company gives it significant influence over RST Company and
- Public Pension Trust Fund’s investment in RST Company is material to XYZ State’s financial statements as a whole.

Firm A should apply the “Independence Rule” and related interpretations to RST Company.

If RST Company had an investment in NOP Company, Firm A would not need to evaluate the investment in NOP Company because RST Company is not considered an investor as defined in the interpretation. As paragraph .03c of the interpretation indicates, the evaluation ceases with the original investment.

In addition, Firm A may not use the nonattest services exception.

If Public Pension Trust Fund’s investment in RST Company did not give Public Pension Trust Fund at least significant influence over RST Company, or if Public Pension Trust Fund’s investment in RST Company was not material to XYZ State’s financial statements as a whole, RST Company would not be an affiliate of XYZ State.

Exhibit D.4.2 provides a visual of the conclusion that RST Company is an affiliate of XYZ State under paragraph .03aiv(2) of the interpretation.

Exhibit D.4.2: par. .03aiv(2) example

*Before starting here, Firm A used the control investment pathway (exhibit C.1).
Conceptual Framework for Independence

So far, this guide has focused on evaluating affiliate relationships to determine which entities require independence. It is important to note that you may also encounter other circumstances or relationships that create threat to independence. Such situations could necessitate consulting the “Conceptual Framework for Independence” for guidance. Paragraph .06 of the interpretation includes examples of such circumstances or relationships; however, those examples are not all-inclusive. This section of the guide will walk you through additional examples to help you understand when you might need to consult the conceptual framework and how it can assist you.

When might you consult the “Conceptual Framework for Independence”?

The conceptual framework provides guidance when it comes to determining if threats to independence exist either in substance or appearance — and what to do when you find them. The following scenarios, though hypothetical, will give you an idea of how you can apply the conceptual framework in the SLG environment.

Here are some factors to keep in mind as you read through the scenarios:

- Special District, a blended component unit of JKL City, asks Firm A to perform its audit.
- Partner 1 and Partner 2 are partners in Firm A.
- Partner 2 will be the audit partner on Special District.
- Firm A does not audit JKL City.

In each scenario, Firm A should consider threats to independence. If threats are not at an acceptable level, Firm A will need to apply safeguards sufficient to eliminate threats or reduce them to an acceptable level. If Firm A cannot sufficiently mitigate any significant threats and chooses to perform the engagement anyway, Firm A’s independence will be impaired.

Scenario 1: Employment relationships

The situation

Partner 1’s wife is the financial reporting manager for JKL City. Among other things, she is in charge of preparing the city’s comprehensive annual financial report (CAFR) and overseeing members of her team who perform the accounting functions for Special District.

The question

Does Partner 1’s wife’s position create threats to Firm A’s independence in Special District’s audit?

The key factors

Here are two important points to consider in this situation:

1. Partner 1’s wife is a covered member’s immediate family member in Special District’s audit.
2. Her responsibilities include oversight of accounting functions at Special District.
The conclusion

Firm A consults the conceptual framework and determines that Partner 1’s wife’s role creates management participation, familiarity, and self-interest threats to Partner 1’s compliance with the “Independence Rule” in Special District’s audit. However, after reviewing Partner 1’s wife’s role further, Firm A discovers that she does not prepare Special District’s financial statements. The accounting manager in Partner 1’s wife’s department prepares the financial statements and then Special District’s executive director reviews them. Partner 1’s wife reviews the financial statements only in preparing the city’s CAFR. Firm A also assigns a partner from another office to perform the concurring review on the audit. After considering the safeguards at Special District and at the firm, Firm A determines that threats are reduced to an acceptable level, concludes it is independent, and performs the audit for Special District.

Scenario 2: Nonattest services

The situation

Special District engaged Firm A to perform an audit of fiscal year 20XX. The following year, JKL City asks whether Firm A can provide financial reporting design services for JKL City’s new enterprise resource planning system. Special District will also use the financial reporting module of that system.

The question

Does the proposed nonattest service create threats to Firm A’s independence in Special District’s audit?

The key factors

Here are two important points to consider in this situation:

1. The nonattest service may be a prohibited service if performed directly for an FSAC.
2. The nonattest service will be subject to the audit of Special District.

The conclusion

Firm A consults the conceptual framework and determines that

- self-review and management participation threats would exist if it performed the design services during the period of the professional engagement and
- the threats would not be at an acceptable level.

Even though Special District would not be directly engaging Firm A to perform the design services, Special District would be using the financial reporting module that Firm A designed. Firm A determines that independence would be impaired because there are no safeguards it could implement that would reduce the threats to an acceptable level. Accordingly, Firm A should not pursue the design services engagement with JKL City.
Scenario 3: Financial interests

It’s not just relationships and service types that can cause threats to independence. Firm A might also need to consult the conceptual framework to assess threats if Partner 1 owns any of the following types of bonds or debt securities:

- Utility bonds issued by JKL City, for which Special District is responsible for the debt service payments
- Conduit revenue bonds issued by Special District for purposes of funding the construction of a pollution control facility for a private entity

The situation

Assume Partner 1 owns municipal bonds issued by JKL City. How can the conceptual framework help Firm A navigate this situation?

The question

Do the municipal bonds owned by Partner 1 create threats to Firm A’s independence in Special District’s audit?

The key factors

Here are four important points to consider in this situation:

1. Partner 1 will not be on the Special District attest engagement team but is a covered member because he is a partner in the office. As such, the self-interest threats are not as significant as they would be for a partner serving on the attest engagement team.
2. Partner 1 will not provide any professional services to Special District or to JKL City.
3. Partner 1’s financial interests are not in the proposed FSAC or in its affiliates.
4. Because Firm A has 30 partners and 300 professional employees, Partner 1 has virtually no influence over the proposed audit.

The conclusion

Firm A consults the conceptual framework and concludes that the self-interest threat related to Partner 1 having a financial interest in JKL City is at an acceptable level. However, if any or all the factors mentioned earlier were to change, Firm A might conclude that threats were not at an acceptable level and would need to apply safeguards to eliminate the threats or reduce them to an acceptable level.
What other resources are available to help?

In addition to this guide, there are four practice aids that will help you in different ways: the SLG entity affiliate evaluator, the SLG investment affiliate evaluator, the interactive SLG affiliate matrix, and the Conceptual framework tool kit for independence. Although these tools may help you in your decision-making process, you should use your professional judgment in reaching conclusions.

**SLG affiliate calculator: Entities**

This tool will walk you through a step-by-step analysis of whether an entity is an affiliate of your FSAC under paragraph .03ai–iii of the interpretation. Simply launch the tool and answer yes or no to each question. After you've answered all the questions, you'll get a summary page with your result. You'll need to fill in the name of the entity you're evaluating as well as any discussion points you want to document.

**But what about investments?**

**SLG affiliate calculator: Investments**

Using a similar approach to the entity affiliate calculator, the investment calculator will give you a result based on the yes or no answers you enter in response to a series of questions. This tool will help you decide if an investee is an affiliate under paragraph .03aiv(1)–(2) of the interpretation. You'll need to fill in the name of the investee you're evaluating. There is a place for notes as well.

The purpose of these two tools is to make the decision-making process as clear as possible. But what if you prefer to evaluate all entities and investments at one time? Let's take a look at the Microsoft Excel-based tool.

**Interactive SLG affiliate matrix**

This tool will give you a place to capture all potential affiliates and consider the individual criteria required to make your affiliate determinations. Based on your choices from the drop-downs, the tool indicates whether each entity or investment is an affiliate; if it is, the tool provides you with the appropriate reference to the interpretation.

And lastly, to help you evaluate potential threats to independence that may come from relationships or circumstances that might not be directly addressed in the interpretation...

**The conceptual framework toolkit for independence**