North Carolina
Office of the State Controller

2019 ASB Update
June 5, 2019

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Auditing Standards

- **Standards Setters:**
  - AICPA/ASB = Generally Accepted Auditing Standards = GAAS
  - GAO = Government Auditing Standards = Yellow Book = GAGAS
  - OMB = Single Audit Guidance = A-133/New Uniform Guidance
Standards Setters (cont’d):

- IFAC/IAASB (International Auditing and Assurance Standards Board) = International Audit Standards = ISAs
- PCAOB/SEC = Standards for Publicly Traded Companies = AS
- States may prescribe additional standards.

SAS 132

The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern
SAS 132, The Auditor’s Consideration of the Entity’s Ability to Continue as a Going Concern

- Supersedes SAS 126 of the same title
- Effective for periods ending on or after December 15, 2017
- Calendar Year, 2017 and Fiscal Year July 1, 2017 to June 30, 2018
- Revised, using IFAC ISA 570 as the base, to reflect FASB ASU 2014-15 and GASB No. 56. This impacted
  - Definition of reasonable period of time
  - Definition of substantial doubt
  - Interim financial statements
  - Disclosures & management’s plan

- Now codified at AU-C 570

Going Concern – Differences between GAAP and GAAS

- Period of time related to the going concern assessment
  - GAAS – “reasonable period of time”: not to exceed one year from date of financial statements.
  - FASB GAAP – one year from date of issuance of financial statements
  - GASB GAAP – one year from date of financial statements (plus additional three months)
SAS 132, Going Concern - Changes

- FASB - Accounting Standards Codification (ASC) requires management to evaluate whether there are conditions and events, considered in the aggregate, that raise substantial doubt about an entity’s ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable).

- GASB - Statement No. 56, Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards, requires financial statement preparers to evaluate whether there is substantial doubt about a governmental entity’s ability to continue as a going concern for 12 months beyond the date of the financial statements. GASB Statement No. 56 further requires that, if information is currently known to the governmental entity that may raise substantial doubt shortly thereafter (for example, within an additional three months), such information should also be considered.

GAAS Reasonable Amount of Time:

- The period of time required by the applicable financial reporting framework or, if no such requirement exists, within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable). (Ref: par. .A6)
SAS 132, *Going Concern - Changes*

**Auditor’s objectives and related conclusions:**
- To obtain sufficient appropriate audit evidence regarding, and to conclude on, the appropriateness of management's use of the going concern basis of accounting, when relevant, in the preparation of the financial statements.
- To conclude, based on the audit evidence obtained, whether substantial doubt about an entity’s ability to continue as a going concern for a reasonable period of time exists.
- To evaluate the possible financial statement effects, including the adequacy of disclosure regarding the entity’s ability to continue as a going concern for a reasonable period of time.
- To report in accordance with this section.

**Evaluation:**
- Consider the results of risk assessment procedures (Understanding the Entity, its Environment and the Risk of Material Misstatements).
- Consider management’s assessment of conditions that would raise substantial doubt and management’s plans to address conditions that raise substantial doubt.
- If management has not made an assessment, inquire as to management’s basis for using a “going concern basis of accounting.” Inquire of management about the existence of conditions or events that raise substantial doubt about an entity’s ability to continue as a going concern for a reasonable period of time.
SAS 132, Going Concern - Changes

**Evaluation (cont’d):**

- The auditor should remain alert throughout the audit for audit evidence of conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. (Ref: par. .A17)
- The auditor should inquire of management regarding its knowledge of conditions or events beyond the period of management's evaluation that may have an effect on the entity's ability to continue as a going concern. (Ref: par. .A23, .A25–.A27)

**Evaluation when Events or Conditions are Identified:**

- Request management to make an evaluation if management has not
- Evaluate whether management’s plans can be effectively implemented and whether those plans will mitigate the substantial doubt
- If management has prepared a cash forecast that is a significant factor in its plan, determine whether the underlying assumptions and data support the analysis
- Consider any additional available evidence subsequent to the date management prepared its plan
SAS 132, *Going Concern* - Changes

**Evaluation when Events or Conditions are Identified (cont’d):**

- If a third party is willing to provide necessary financial support as part of the plan:
  - Determine in writing the intent of the third party. Failure to do so constitutes a lack of sufficient appropriate audit evidence.
  - Determine the ability of the third party to provide the necessary financial support.

**Evaluation when Events or Conditions are Identified (cont’d):**

- Obtain Representations:
  - A description of management’s plans that are intended to mitigate the adverse effects of conditions or events that indicate there is substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time and the probability that those plans can be effectively implemented
  - That the financial statements disclose all the matters of which management is aware that are relevant to the entity’s ability to continue as a going concern for a reasonable period of time, including principal conditions or events and management’s plans
SAS 132, *Going Concern* - Changes

**Auditor Conclusions:**

- Use of going concern basis of accounting is appropriate
- Based on audit evidence obtained, conclude whether there are conditions or events that create substantial doubt
- Evaluate management's disclosures

**Auditor Conclusions about the Adequacy of Disclosures:**

- The auditor should evaluate the adequacy of the financial statement disclosures as required by the applicable financial reporting framework. (Ref: par. A41–A44)
  
  - Adequacy of Disclosure When Conditions or Events Have Been Identified and Substantial Doubt Has Not Been Alleviated
  
  - Adequacy of Disclosures When Conditions or Events Have Been Identified But Substantial Doubt Has Been Alleviated by Management's Plans
SAS 132, *Going Concern* - Changes

**Implications for the Auditor’s Report:**

- Use of Going Concern Basis of Accounting Is Inappropriate = **Adverse Opinion**
- Use of the Going Concern Basis of Accounting Is Appropriate But Conditions and Events Have Been Identified = **Emphasis of a Matter Paragraph**
- Adequate Disclosure About an Entity’s Ability to Continue as a Going Concern Is Not Made in the Financial Statements = **Qualified Opinion**
- Management Unwilling to Perform or Extend Its Evaluation = **Consider the Implications**
- Eliminating a Going Concern Emphasis-of-Matter Paragraph From a Previously Issued Report = **Additional Audit Evidence Necessary, perform additional evaluations**
- Significant Delay in the Issuance of Financial Statements = **Perform additional evaluation**

**Communications with Those Charged with Governance** should include the following:

- Whether the conditions or events, considered in the aggregate, that raise substantial doubt about an entity’s ability to continue as a going concern for a reasonable period of time constitute substantial doubt
- The auditor’s consideration of management’s plans
- Whether management’s use of the going concern basis of accounting, when relevant, is appropriate in the preparation of the financial statements
- The adequacy of related disclosures in the financial statements
- The implications for the auditor’s report
SAS 132, *Going Concern - Changes*

**Auditor’s Documentation if Substantial Doubt Exists:**

- The conditions or events that led the auditor to believe there is substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time.

- The elements of management's plans that the auditor considered to be particularly significant to overcoming the conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern, if applicable.

- The audit procedures performed to evaluate the significant elements of management's plans and evidence obtained, if applicable.

**Auditor’s Documentation if Substantial Doubt Exists (cont’d):**

- The auditor’s conclusion regarding whether substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains or is alleviated.
  - If substantial doubt remains, the auditor should also document the possible effects of the conditions or events on the financial statements and the adequacy of the related disclosures.
  - If substantial doubt is alleviated, the auditor should also document the auditor's conclusion regarding the need for, and, if applicable, the adequacy of, disclosure of the principal conditions or events that initially caused the auditor to believe there was substantial doubt and management's plans that alleviated the substantial doubt.

- The auditor's conclusion with respect to the effects on the auditor's report.
**SAS 132, Going Concern - Changes**

- The auditor cannot predict the future. Accordingly, the absence of any reference to substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time in an auditor’s report cannot be viewed as a guarantee of the entity’s ability to continue as a going concern for a reasonable period of time.

**SAS 132, Going Concern - Changes**

- AU-C 800, Financial statements prepared in accordance with a special-purpose framework
  - Going concern basis may not be relevant to the applicable reporting framework, but
  - Need to consider if substantial doubt exists
SAS 132, *Going Concern* - Changes

- **AU-C 930, *Interim Financial Information*, amended**
  - Required procedures for when the applicable financial reporting framework does, or does not, require management to evaluate going concern for interim periods
  - Emphasis-of-matter paragraphs required under specified circumstances

SAS 133

- **AUDITOR INVOLVEMENT WITH EXEMPT OFFERING DOCUMENTS**
SAS 133, Auditor Involvement with Exempt Offering Documents

- Issued July 2017, effective for exempt offering documents that are initially distributed, circulated, or submitted on or after June 15, 2018
- Calendar Year 2018 and Fiscal Year July 1, 2018 to June 30, 2019

Requirements when auditor is involved with exempt offering document
  - Subsequent events
  - Other information

Involvement determined by two benchmarks
  - Inclusion of auditor report in exempt offering document
  - Auditor meets one or more "trigger" activities

**Auditor Involvement – Exempt Offerings**

**Triggers for Involvement - Current:**
  - Assisting the entity in preparing information included in the offering document
  - Reading a draft of the offering document at the entity’s request
  - Issuing a comfort or similar letter in accordance with AU-C section 920, *Letters for Underwriters and Certain Other Requesting Parties*, or an attestation engagement report in lieu of a comfort or similar letter on information included in the offering document
  - Participating in due diligence discussions with underwriters, placement agents, broker-dealers, or other financial intermediaries in connection with an offering document
  - Issuing an attestation report on information relating to the offering
  - Providing written agreement (for example, an inclusion letter) for the use of the auditor’s report in the offering document
  - Updating, Signing a copy of the auditor’s report for inclusion in the offering document
Auditor Involvement – Exempt Offerings

Exempt Offerings:

• Securities exempt from registration under the Securities Act of 1933, as amended or
• Franchise offerings regulated by the Federal Trade Commission.

Our Engagement Letter/Representation Letter

Management is responsible for exempt debt offering documents. The provision of audit services under this Engagement Letter of Understanding does not constitute involvement with any exempt debt offering. The inclusion of our audit report in any exempt offering document does not constitute auditor involvement with the exempt offering. The Division of Local Government Audit will not provide services in conjunction with our audit that constitute involvement with any exempt offering as defined by auditing standards generally accepted in the United States of America.
Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements

SAS No. 134 significantly changes the form and content of the auditor’s report issued after auditing a set of financial statements. The SAS also addresses the auditor’s responsibility to form an opinion on the financial statements. The auditor reporting suite of standards will benefit users of audited financial statements throughout the U.S. by placing the auditor’s opinion at the front of the report for added visibility and providing necessary transparency into the basis for the auditor’s opinion and the responsibilities of both entity management and auditors.
SAS 134, Auditor Reporting and Amendments

- SAS No. 134 is a suite of auditor reporting standards that includes a new AU-C section 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*, and replaces the following AU-C sections in AICPA Professional Standards:
  - Section 700, *Forming an Opinion and Reporting on Financial Statements*
  - Section 705, *Modifications to the Opinion in the Independent Auditor’s Report*

Effective date:

- Effective for audits of financial statements for periods ending on or after December 15, 2020.
- Early implementation is not permitted.
- Calendar Year, 2021 or Fiscal Year July 1, 2021 to June 30, 2022.
SAS 134, Auditor Reporting and Amendments

- "The auditor reporting suite of standards will benefit users of audited financial statements throughout the U.S. by placing the auditor’s opinion at the front of the report for added visibility and providing necessary transparency into the basis for the auditor’s opinion and the responsibilities of both entity management and auditors," Bob Dohrer, CPA, CGMA, the AICPA’s chief auditor, said in a news release.

- In the past five years, the PCAOB and the IAASB have issued auditor reporting standards that are designed to assist practitioners in satisfying users’ needs for more information. The PCAOB standard requires reporting of “critical audit matters” that are discovered during the audit, while the IAASB standard instructs practitioners on the reporting of “key audit matters.”

SAS 134, Auditor Reporting and Amendments

- SAS No. 134 does not require reporting of key audit matters in an engagement but provides reporting requirements for communication of key audit matters in the auditor’s report when the auditor is engaged to do so.

- SAS No. 134 addresses the auditor’s responsibility to form an opinion on the financial statements and provides new guidance for the form and content of the auditor’s report. The standard also contains requirements for when the auditor concludes that a modification to the auditor’s opinion on the financial statements is necessary, and when additional communications are necessary in the auditor’s report.
This suite of auditor reporting standards includes a new AU-C Section 701, Communicating Key Audit Matters in the Independent Auditor’s Report, and replaces the following AU-C sections in AICPA Professional Standards:
- Section 700, Forming an Opinion and Reporting on Financial Statements.
- Section 705, Modifications to the Opinion in the Independent Auditor’s Report.

SAS 134, Auditor Reporting and Amendments

- Establishing ‘Basis for Opinion’
  - SAS No. 134 requires that the “Opinion” section precede the “Basis for Opinion” section in the auditor’s report. SAS No. 134 also describes the contents of the “Basis for Opinion” section, which is now required for all reports, not just those with modified opinions. The “Basis for Opinion” section will set users’ expectations for the auditor’s report and will:
    - State that the audit was conducted in accordance with GAAS and identify the United States as the country of origin of those standards.
    - Refer to the section of the auditor’s report that describes the auditor’s responsibilities under GAAS.
    - Include a statement that the auditor is required to be independent of the entity and to meet other ethical responsibility requirements.
    - State whether the auditor believes the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor’s opinion.
New requirements for going concern also are included in the new standard. If the financial statements do not include adequate disclosure about an entity’s ability to continue as a going concern for a reasonable period, new requirements for the auditor include stating in the “Basis for Qualified (Adverse) Opinion” section that:

- Substantial doubt exists about the entity’s ability to continue as a going concern and that the financial statements do not adequately disclose this matter; or

- Substantial doubt exists about the entity’s ability to continue as a going concern has been alleviated by management’s plans but the financial statements do not adequately disclose this matter.

**Auditor Reporting**

**GOAL:**
- Enhancing the communicative value and relevance of the auditor’s report

**IAASB Auditor Reporting Project**
- New section:
  - ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*
- Amendments to other auditor reporting sections:
  - ISA 700
  - ISA 705
  - ISA 706
  - ISA 260
  - ISA 570
IAASB Auditor Reporting Standards

- Opinion section mandated first
- New sections:
  - Key Audit Matters
    - Applicable to audits of listed entities
    - “What keeps the auditor up at night”
  - Going Concern
  - Other Information
    - When presented with the audited financial statements
    - Separate project to revise ISA 720
- Other proposed improvements to enhance transparency and clarify responsibilities

Illustration 3: An Auditor’s Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

- Circumstances include the following:
  - Audit of a complete set of general purpose financial statements (single year).
  - The audit is not a group audit.
  - Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
  - The terms of the audit engagement reflect the description of management’s responsibility for the financial statements in AU-C section 210, Terms of Engagement.
  - The auditor has concluded that an unmodified (that is, “clean”) opinion is appropriate based on the audit evidence obtained.
  - Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570, The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern.
  - The auditor has not been engaged to communicate key audit matters.
Opinion Paragraph Presented First

Independent Auditor's Report

[Appropriate Addresses]

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Followed by the Basis for Opinion

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.
New Responsibilities for Management

- Responsibilities of Management for the Financial Statements
  - Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.
  - In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company’s ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

New Auditor’s Responsibilities

- Auditor’s Responsibilities for the Audit of the Financial Statements
  - Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.
In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company’s internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company’s ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.
Modified Opinions are based on Pervasiveness

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<th>Nature of Matter Giving Rise to the Modification</th>
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<td>Material but Not Pervasive</td>
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<td>Financial statements are materially misstated</td>
<td>Qualified opinion</td>
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<td>Inability to obtain sufficient appropriate audit evidence</td>
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Definitions – Emphasis of a Matter and Other Matter

- **Emphasis of a Matter:**
  - Draws users’ attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users’ understanding of the financial statements (emphasis-of-matter paragraph)

- **Other Matter:**
  - Draws users’ attention to any matters other than those presented or disclosed in the financial statements that are relevant to users’ understanding of the audit, the auditor’s responsibilities or the auditor’s report (other-matter paragraph).
Communication with Those Charged with Governance

If the auditor expects to include an emphasis-of-matter or other-matter paragraph in the auditor’s report, the auditor should communicate with those charged with governance regarding this expectation and the wording of the paragraph. (Ref: par. .A16)

Definitions – Key Audit Matter

Key Audit Matter:
• Those matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.
• Auditors are not required to include Key Audit Matters in the Independent Auditor’s Report.
AU-C Section 706


Illustration 2: An Auditor's Report That Includes a Key Audit Matters Section, an Emphasis-of-Matter Paragraph, and an Other-Matter Paragraph

Emphasis of a Matter - Illustration

Emphasis of Matter
- As discussed in Note X to the financial statements, subsequent to the date of the financial statements, there was a fire in ABC Company's production facilities. Our opinion is not modified with respect to this matter.

As noted in paragraph .A14, an emphasis-of-matter paragraph may be presented either directly before or after the “Key Audit Matters” section, based on the auditor's judgment about the relative significance of the information included in the emphasis-of-matter paragraph.
Key Audit Matters - Illustration

Key Audit Matters
- Key audit matters are those matters that were communicated with those charged with governance and, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. [Description of each key audit matter in accordance with section 701, Communicating Key Audit Matters in the Independent Auditor’s Report, of this SAS.]

Other Matters - Illustration

Other Matter
- The financial statements of ABC Company for the year ended December 31, 20X0, were audited by another auditor, who expressed an unmodified opinion on those statements on March 31, 20X1.
Emphasis of a Matter Issues

- An uncertainty relating to the future outcome of unusually important litigation or regulatory action
- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor’s report
- A major catastrophe that has had, or continues to have, a significant effect on the entity’s financial position or results of operations
- Significant transactions with related parties
- Would not be disclosed as a “Key Audit Matter”
- Should indicate that the auditor’s opinion is not modified with respect to the matter emphasized.

Emphasis of a Matter Requirements:

- Paragraph .16c of section 560, Subsequent Events and Subsequently Discovered Facts
- Paragraphs .08–.09 and .11–.13 of section 708, Consistency of Financial Statements
- Paragraphs .19 and .21 of section 800, Special Considerations — Audits of Financial
- Statements Prepared in Accordance With Special Purpose Frameworks
Other Matter Requirements

- Paragraph .16c of section 560, Subsequent Events and Subsequently Discovered Facts
- Paragraphs .55–.56 and .58–.59 of section 700, Forming an Opinion and Reporting on Financial Statements, of this SAS
- Paragraphs 53, 92–93, 95–96, 121, and 133 of SAS Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA
- Paragraph .09 of section 725, Supplementary Information in Relation to the Financial Statements as a Whole
- Paragraph .07 of section 730, Required Supplementary Information

Other Matter Requirements (cont’d)

- Paragraph .20 of section 800, Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks
- Paragraph .13 of section 806, Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements
- Paragraph .07 of section 905, Alert That Restricts the Use of the Auditor’s Written Communication
SAS 135, Omnibus Statement

- Increased communication with those charged with governance.
- More audit inquiries and audit evidence concerning related party transactions.
- Communications with the predecessor auditor about related party transactions.
- “Significant unusual transactions” replaces “transactions that are outside the normal course of transactions for the entity or that otherwise appear to be unusual.”
- The relationship between significant unusual transactions and fraud.
- Additional subsequent event inquiries about related parties and unusual transactions.
- Increased representations concerning related parties.
Professional Ethics Executive Committee (PEEC)

Proposed Interpretation ED, State and Local Government Client Affiliates (formerly Entities Included in State and Local Government Financial Statements)

Issued January 2019

Questions

Jerry E. Durham, CPA, CGFM, CFE