



## Agenda Item 5

### NOCLAR

#### Objective of Agenda Item

To update the ASB on the current status of the project to revise AU-C section 210, *Terms of Engagement* to require communication to successor auditors if the predecessor auditor withdraws from an engagement, decides not to stand for reappointment, or is terminated, and noncompliance with laws or regulation (NOCLAR) has been identified or is suspected. The NOCLAR Task Force (the “Task Force”) is also presenting a draft of the proposed amendment and requesting ASB feedback.

#### NOCLAR Task Force

Harry Cohen – Task Force Chair and current ASB Member

Lawrence Gill – Former ASB Member

Gaylen Hansen – Former ASB Member

Bill Mann – Immediate past member of the Professional Ethics Executive Committee (PEEC) and General Counsel and National Director of Independence at Mayer Hoffman McCann, PC

The Task Force is staffed by Mike Glynn.

#### Background

The International Ethics Standards Board for Accountants (IESBA) Code of Ethics for the Professional Accountant (IESBA Code) was revised in July 2016 to require, in the absence of any law prohibiting disclosure of confidential information to an outside party, the disclosure of identified or suspected NOCLAR to an appropriate authority even if not required by law where necessary in the public interest.

In 2016, the IAASB revised ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, to reflect the changes in the IESBA Code of Ethics.

In March 2017, the AICPA’s Professional Ethics Executive Committee (PEEC) issued an exposure draft with proposals for two new interpretations entitled “Responding to Non-Compliance with Laws and Regulations.” The intent was to conform to NOCLAR standards promulgated by IESBA. While similar to the IESBA’s interpretation, the PEEC’s proposal departed from the international standard because most state accountancy boards and the AICPA Code of Professional Conduct do

not permit a CPA to disclose confidential client information such as NOCLAR without client or employer consent unless required by professional standards or to comply with a subpoena or laws/regulations. Section 18 of the Uniform Accountancy Act (UAA) reads as follows (*emphasis added*):

#### CONFIDENTIAL COMMUNICATIONS

Except by permission of the client for whom a licensee performs services or the heirs, successors, or personal representatives of such client, a licensee under this Act, shall not voluntarily disclose information communicated to the licensee by the client relating to and in connection with services rendered to the client by the licensee. Such information shall be deemed confidential, provided, *however, that nothing herein shall be construed as prohibiting the disclosure of information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements* or as prohibiting compliance with applicable laws, government regulations or PCAOB requirements, disclosures in court proceedings, in investigations or proceedings under Sections 11 or 12 of this Act, in ethical investigations conducted by private professional organizations, or in the course of peer reviews, or to other persons active in the organization performing services for that client on a need to know basis or to persons in the entity who need this information for the sole purpose of assuring quality control.

In response to the PEEC exposure draft, the National Association of State Boards of Accountancy (NASBA) submitted a comment letter expressing concerns that the proposed language would discourage CPAs from acting in the public interest even after the CPA demonstrated compliance with all relevant professional standards and may also be construed as either limiting or prohibiting a NOCLAR disclosure without written client consent.

The PEEC has not adopted the proposed interpretations. As an option to further address NOCLAR, the PEEC requested that the ASB consider revisions to GAAS to require communication to successor auditors of a former client when NOCLAR has been identified or is suspected by the predecessor auditor. Until further PEEC deliberations with regard to the interaction with state law and potential changes to the Code of Conduct are proposed, the PEEC did not request that the ASB consider revisions to GAAS that would require auditors to report NOCLAR to other outside parties, such as the appropriate authorities.

In consideration of PEEC's request, a project proposal was developed and presented to the Audit Issues Task Force (AITF) in November 2019. The AITF approved the project proposal as presented and the NOCLAR Task Force was formed.

During its meeting in December 2019, the ASB considered potential alternatives and provided feedback and direction for Task Force consideration on potential revisions to GAAS.

At its meeting in January 2020, the ASB considered proposed revisions to AU-C section 210. The ASB supported the Task Force's proposed approach regarding the predecessor auditor's responsibility to communicate with a successor auditor with respect to identified or suspected fraud and matters involving NOCLAR. The ASB believed that it is in the public interest for a knowledge transfer from the predecessor auditor to the successor auditor to take place with respect to

identified or suspected fraud and matters involving NOCLAR. Further, the Board was opposed to an approach that would require the client to provide explicit consent as either a precondition for the audit or as a required element of the terms of the engagement.

At that January 2020 meeting, the ASB was presented with information that initially indicated, without explicit client consent, state laws and regulations in only 8 states may permit a predecessor auditor to respond to a successor auditor's inquiries with respect to identified or suspected fraud and matters involving NOCLAR that come to the auditor's attention during the audit. With this information, the ASB expressed concern that the Board's understanding of the current state of local laws and regulations coupled with an absence of a requirement for the auditor to obtain the client's explicit consent to such communications prior to commencing the audit, the proposed standard would not accomplish the intended knowledge transfer between the predecessor and successor auditors.

Subsequent to the January 2020 ASB meeting and at the request of AICPA staff, NASBA researched in a more comprehensive manner the laws and regulations of all licensing jurisdictions and determined that 52 of 55 jurisdictions provide for an exemption that would permit the communication between predecessor and successor auditors. The remaining 3 jurisdictions may also allow the communication subject to an interpretation of their laws and rules. The information presented during the January 2020 ASB meeting was based on research conducted by NASBA prior to the proposal for the ASB to include the predecessor/successor communication requirement in the auditing standards and thus did not contemplate the "compliance with standards" provision of Section 18 of the UAA cited previously. The NOCLAR Task Force believes that this new evaluation and information sufficiently alleviates the initial concerns raised by the ASB at its January 2020 meeting.

## **Discussion with the ASB**

The draft proposed amendments to AT-C section 210 include revisions directed by the ASB at its meeting in January 2020. The ASB is asked to provide feedback to the Task Force as to whether additional revisions to the proposed amendments are needed.

## **Proposed Timeline**

- October 2020** – The Task Force to present draft amendments and request that the ASB vote to expose the proposed amendments for public comment
- April 2021** – Comment period ends
- May 2021** - ASB to consider comments received on exposure draft of proposed amendments
- July 2021** - The Task Force to present final draft amendments and request that the ASB vote to issue as a final SAS

**Agenda Items Presented:**

Agenda item 5A Proposed SAS, *Communication With Predecessor Auditor Regarding Fraud and Noncompliance With Laws and Regulations* – clean

Agenda Item 5B Proposed SAS, *Communication With Predecessor Auditor Regarding Fraud and Noncompliance With Laws and Regulations* – marked to show changes from the draft presented to the ASB in January 2020

Note – as the draft amendments are presented in ***boldface italics*** and ~~striketrough~~, agenda item 5A (the clean draft) effectively serves as a markup from extant AU-C section 210.

Mr. Cohen will refer to agenda item 5B in walking the ASB through the proposed amendment.