Private Companies
Practice Section

June 29, 2021

Ms. Toni Lee-Andrews
Ethics Team
AICPA
220 Leigh Farm Road
Durham, NC 27707

Re: PEEC Proposed Interpretations and Definition: Responding to Noncompliance with Laws and Regulations (NOCLAR) (hereafter, the Interpretations)

Dear Ms. Lee-Andrews:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to speak on behalf of local and regional firms and represent those firms' interests on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective.

TIC continues to have concerns about the Interpretations, many of which were communicated in our previous comment letter dated May 23, 2017. In addition, TIC notes that from an auditor's perspective, responsibilities regarding NOCLAR already are addressed elsewhere, such as AU-C Section 250, at an appropriate scope and level of responsibility.

TIC agrees that it is in the public interest for practitioners to report on matters or events of NOCLAR that are identified during the course of the engagement for which the practitioner was engaged. However, TIC believes the Interpretations, as currently proposed, may expand the scope of existing engagements thereby creating the possibility for an increased expectation gap between what services a practitioner was engaged to perform and what the general public believes a practitioner is performing.

Scope
(.07-.10)

Please note that unless otherwise indicated, all paragraph references are in relation to the proposed guidance applicable to members in public practice.

Expansion of Requirements for NOCLAR
TIC believes that the scope of the Interpretations as proposed in paragraphs 7-10 are fundamentally too broad as they could be interpreted as placing additional responsibilities on

members related to NOCLAR that are beyond the scope of what would be required by applicable professional standards of the underlying engagement and level of service.

As previously indicated, TIC agrees that noncompliance or suspected noncompliance that a member becomes aware of should be reported. However, TIC remains concerned that, without clarification or limitation, the wording around what a member "encounters or is made aware of" regarding noncompliance is vague and, therefore, open to different interpretations. While we acknowledge that this wording is consistent with the IESBA and that PEEC has indicated in .37 of the Explanations to the Interpretations PEEC believes that it does not require further clarification and does not imply that additional procedures are required, TIC does not agree that this is the case.

As an example, what a member "encounters or is made aware of" would differ based on the level of effort put forth by the member to seek out such information. A member who actively seeks out information on social media, or performs additional procedures that are outside of what is required by the engagement standards, is more likely to encounter or be made aware of information than a member who only follows what is required by the standards of the engagement they are performing.

TIC believes that the lack of clarity around this point is problematic for several reasons including:

- The lack of clarity could result in diversity in practice in the level of work that members believe they need to perform in relation to this area.
- Members may receive findings on peer reviews as a result of a reviewer having a different interpretation of this wording and what procedures are required. This also could occur as a result of a peer reviewer seeing documentation or procedures performed that is/are believed to be superior and is used by one member and then expecting the same level on other reviews when such procedures are not required.
- The general public could misunderstand the procedures that are required to be performed by the member to encounter information which would further enhance misconceptions on the role and responsibilities of the member.
- In the event of litigation, members would be put in a position to have to defend their interpretations of the amount of work they performed as a direct result of the terminology used in the Interpretations. While we acknowledge the wording is the same as used by the IESBA, the legal environment in the United States is much different than other parts of the World.

TIC strongly believes that the scope section should be modified to include explicit limitations on the requirements imposed on members with regards to encountering or being made aware of NOCLAR. This could be achieved by modifying .07 to indicate that the scope of the Interpretations is limited to matters of NOCLAR that are identified as part of the engagement based on the procedures required by applicable professional standards of the underlying engagement and level of service. Wording which TIC believes would accomplish this in .07 is added in bold italics below:

> .07 This interpretation sets out the approach to be taken by a member who encounters or is made aware of noncompliance or suspected noncompliance ***while performing the required procedures for the engagement*** with the following:

In addition, TIC suggests that the first two sentences of paragraph .14 be included in the Scope section as we believe that this is critical to limiting the expectation that members will detect NOCLAR that is clearly beyond the expertise of the member and the requirements of the engagement.

Further, the scope paragraphs in the Interpretations apply to members in public practice, who perform many other services aside from audits. Paragraphs .07a and .07b generally are consistent with the auditing standards (AU-C 250); however, they would not apply to non-audit engagements.

TIC also is concerned that paragraph .08 contains some examples of laws and regulations, such as environmental protection and public health and safety, that are beyond the expertise of most members and would be unlikely to arise in the conduct of an engagement.

In addition, TIC believes that the term 'noncompliance' as defined in .09 is significantly greater in scope than only being viewed in terms of the noncompliance that has a material impact on the financial statements as the term is used in AU-C 250. While the definition in the Interpretations does maintain the wording related to material effect on the financial statements, the definition is expanded as follows:

> "Importantly, such noncompliance may have wider public interest implications in terms of potentially substantial harm to investors, creditors, employees, or the general public. For the purposes of this interpretation, an act that causes substantial harm is one that results in serious adverse consequences to any of these parties in financial or nonfinancial terms."

Defining noncompliance in terms of potential consequences in both financial and nonfinancial terms to the general public may require a member to speculate about the potential impact of matters where they have no knowledge. Therefore, the expanded definition sets a level of expectation from the public of members (and with it, potential legal liability) that is beyond the training and expertise of public practice members. Based on discussions with several professional liability carriers, TIC also has serious concerns that, in the event of litigation, this perception could expose members to significantly greater liability.

As indicated previously, TIC does believe that the public interest is served through the reporting of instances of NOCLAR identified as part of engagement procedures; however, we do not believe that the public interest is served by inferring a responsibility that is beyond the scope of the engagement or the expertise of members. In lieu of paragraphs .08 and .09, the scope section could simply indicate "Any noncompliance that a member becomes aware of during the performance of an engagement is within the scope of this interpretation."

Use of the Term "Clearly Inconsequential"
Paragraph .10 (.09 for members not in public practice) of the Interpretations notes that:

> " A member who encounters or is made aware of matters that are clearly inconsequential is not required to comply with this interpretation with respect to such matters."

The term "clearly inconsequential" is not defined by ASB in AU-C section 210 or 250 and is not defined by PEEC. TIC's original comment letter raised concerns about how members determine what is clearly inconsequential. For example, *any* harm to an individual generally is more than clearly inconsequential to that individual. In addition, while auditing standards include a separate standard on materiality which includes the concept of clearly inconsequential, TIC notes that, when you involve members outside of audit, their definition of clearly inconsequential could be very different than that of an auditor since they do not have the same basis for reference. TIC continues to believe the term "clearly inconsequential" should be defined or additional context or examples should be added to eliminate potential diversity in practice of application of the term.

Responsibilities of Members in Public Practice
(.12)

TIC does not believe that member's expertise generally extends to understanding "the potential harm to the interests of the entity, investors, creditors, employees or the general public" of noncompliance. To reflect this level of understanding, TIC suggests that paragraph .12 be modified as follows:

> When a member becomes aware of a matter to which this interpretation applies, the member should take timely steps to comply with this interpretation, taking into account the member's understanding of the nature of the matter. ~~and the potential harm to the interests of the entity, investors, creditors, employees, or the general public.~~

Members Providing Financial Statement Attest Services
(.13)

AU-C section 250.06 already contains language outlining the auditor's responsibilities with respect to compliance with laws and regulations. While in this instance the wording in the Interpretations is largely consistent with the existing requirements for an audit engagement and would not result in an increase in scope, the wording in .13 would expand these requirements to other attest engagements. For example, the understanding contemplated in paragraph .13 likely would be less extensive in a compilation engagement than in an audit.

Further, TIC is concerned that the wording related to "other parties" in this paragraph can be viewed as overly broad in imposing responsibility on the member. Without limitation or clarification in the standard, this requirement could be understood as meaning that members are

responsible for reviewing all social media posts made by the general public to determine if there is any credible information concerning instance of noncompliance or suspected noncompliance.

TIC suggests the addition of the language in bold italics to address these concerns:

> .13 If a member engaged to perform financial statement attest services becomes aware of credible information concerning an instance of noncompliance or suspected noncompliance, whether in the course of performing the engagement or through ***direct*** information provided ***to the member*** by other parties, the member should obtain an understanding of the matter ***sufficient to complete the engagement***, including the nature of the act and the circumstances in which it has occurred or is likely to occur.

Addressing the Matter (.19-.21)

TIC strongly recommends striking paragraph .20 of the Interpretations, which indicates the following:

> "The member should consider whether the client's management and, if applicable, those charged with governance understand their legal or regulatory responsibilities with respect to the noncompliance or suspected noncompliance. If not, the member may suggest appropriate sources of information or recommend that they obtain legal advice."

TIC believes that members do not have the ability to conclude whether management or those charged with governance *understand* their responsibilities.

Documentation (.30)

TIC believes that subheading (d.) of paragraph .30 (.44 for members not in public practice) should be eliminated. It should only be necessary to document actions taken vs. all possible courses of action that were considered. Further, the requirement in item (d.) may cause issues with attorney-client privilege considerations when a member has consulted legal counsel. Items (a.) through (c.) of paragraphs .30 and .44 adequately address actions taken.

Also, proposed paragraph .44 for members not in public practice indicates that additional documentation is "encouraged." TIC is concerned that this wording could be perceived as a presumptive mandate and, if a member chose not to include documentation in accordance with the standard, there could be an increased risk to the member in a litigation scenario. Conversely, TIC believes that this wording could result in members taking an approach which results in them documenting excessive amounts of information, which also would increase the litigation risk to the member. TIC's original comment letter noted the following related to documentation:

> TIC believes that members who only provide nonattest services should not be required to document NOCLAR unless the documentation is required by laws or regulations. The proposed Interpretation would require documentation of NOCLAR that would exceed documentation requirements in nonattest engagements. We believe this creates an unnecessary burden on members only performing nonattest services.

TIC also believes that, while encouraging documentation does not carry a 'must' document requirement, it would create a requirement for members to document, or defend, why they did not document NOCLAR.

Other General Comments

The existence of NOCLAR (or indications thereof) create potential legal liability for the member. For this reason, many CPAs routinely consult with risk management advisors when confronted with NOCLAR. Therefore, we request that "risk management advisors" be added to the list of those who may be consulted in paragraphs .14, .29, .32 and .43.

Responses to Specific Requests for Comments Included in the Interpretations

Question 1: *Do you agree with the differentiation in requirements to members in public practice providing services other than financial statement attest services?*

TIC agrees there should be a differentiation in requirements to members in public practice providing services other than financial statement attest services. However, as noted above, TIC sees potential issues with specific requirements.

Question 2: *Do you agree that a litigation or investigation engagement as defined in, and subject to, SSFAS No. 1, and an engagement to which the protections set forth in IRC Section 7525 apply, should be excluded from the proposed interpretation for members in public practice? If not, why? Are there other nonattest services that should be excluded from the proposed interpretation? If yes, please identify which services and explain why.*

TIC agrees that a litigation or investigation engagement should be excluded from the Interpretations for members in public practice.

Question 3: *Is a one-year transition period for the effective date appropriate? If not, why?*

The current proposed effective date of one year after notice, as published in the *Journal of Accountancy*, may not be enough time for practitioners to become aware of and prepare for these changes by ensuring that they have appropriate processes in place and providing appropriate training to all staff. In addition, special consideration to transition requirements for engagements in process at the time of the effective date should be provided.

TIC appreciates the opportunity to present these comments on behalf of PCPS Member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Bryan Bodnar

Chair, On Behalf of the PCPS Technical Issues Committee