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June 21, 2021

Ms. Toni Lee-Andrews
Director of the Professional Ethics Division AICPA
220 Leigh Farm Road
Durham, NC 27707

RE: Exposure Draft, Proposed Interpretations and Definitions, *Responding to Noncompliance with Laws and Regulations*

Dear Ms. Lee-Andrews:

We appreciate the opportunity to provide comments on the exposure draft “Responding to Noncompliance with Laws and Regulations” (the “Exposure Draft”) issued February 25, 2021 by the AICPA Professional Ethics Executive Committee (“PEEC”).

Overall considerations

We are supportive of PEEC’s Exposure Draft to adopt amendments to the Code of Conduct in order to provide AICPA members specific guidance when they encounter noncompliance with laws or regulations (NOCLAR) or suspected NOCLAR. This guidance will align US and International ethics standards and will better serve the public interest.

However, a revision made to paragraph 22 in the re-exposed draft could result in a member’s breach of confidentiality when reporting NOCLAR to a group audit partner without client consent, or with client consent when laws or regulations prohibit the communication. Specifically, the re-exposed draft clarified that the component auditor communicates NOCLAR with the group audit partner in accordance with AU-C Section 600, Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors). AU-C Section 600 does not address the terms of the obligations of the component auditor. As a result, paragraph 22 of the interpretation imposes an affirmative obligation on the member serving as the component auditor to communicate the NOCLAR to the group audit partner. Such disclosure would be in violation of ET 1.700.001 Confidential Client Information rules unless client consent was obtained since the exception in 1.700.001.02 “*This rule shall not be construed (1) to relieve a member of his or her professional obligations of the “Compliance With Standards Rule” or the “Accounting Principles Rule”*” is not met. Including an acknowledgement that a component auditor may have a legal restriction preventing disclosure of the NOCLAR to the group audit partner would allow them to comply with both the interpretation and any jurisdictional restrictions. We recommend adding back “unless prohibited from doing so by law or regulation” at the conclusion of paragraph 22. Furthermore, we recommend providing clear guidance on how NOCLAR would be applied in a group audit so that a member clearly understands the responsibilities of communicating NOCLAR as well as the limitations that compliance with the confidentiality standard require.

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The **Appendix A** contains responses to questions on which PEEC has requested specific feedback and **Appendix B** contains other observations.

We appreciate PEEC's consideration of our comments and observations in support of NOCLAR. If you have any questions regarding our comments included in this letter, please do not hesitate to contact Bill McKeown at wmckeown@kpmg.com or Nancy Miller at nancymiller@kpmg.com.

Sincerely,

KPMG LLP

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Appendix

Appendix A – Responses to questions

Responses to Specific AICPA Questions:

- (a) Do you agree with the differentiation in requirements applicable to members in public practice providing services other than financial statement attest services?**

The link between NOCLAR and the potential effect on the financial statements supports the robust responsibilities related to understanding acts of noncompliance, communicating with those charged with governance, and documenting such matters by a member performing financial statement attest services. As this approach better aligns with the IESBA standard, we are generally supportive.

We note that the attestation standards include guidance that procedures incremental to this interpretation may need to be performed for certain services, other than financial statement attest services. However, we agree with the minimum requirements established in this interpretation.

- (b) Do you agree that a litigation or investigation engagement as defined in, and subject to SSFS 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.**

Yes, we agree that engagements with an objective to investigate a known or suspected NOCLAR should be excluded from the interpretation because it would undermine the purpose of the nonattest service to require adherence to the NOCLAR interpretation. We are not aware of additional specific services that should be excluded; however, PEEC could add a blanket statement in paragraph 6 that engagements whose sole purpose is to address a known or suspected NOCLAR are excluded from the scope of the interpretation if it would be inconsistent with the structure and purpose of the engagement and applicability of various privileges to comply.

- (c) Is a one-year transition period for the effective date appropriate? If not, why?**

Yes, we agree that a one-year transition period is sufficient for adoption and implementation. However, it is not clear whether a member may early adopt the interpretation. We believe that it would appropriate to allow a member to early adopt.

Appendix B – Other observations

For the reasons indicated below, we recommend the Committee consider the following observations and suggested revisions. Revisions are illustrated by underlining proposed additions and striking through proposed ~~deletions~~ assuming the edits proposed within the Exposure Draft are adopted.

Paragraph	Observation
.01	Paragraph .01 defines the “client” as the engaging entity. We believe that the interpretation should use the term “engaging entity” rather than “client” to avoid confusion with other instances within the code where there is a different definition of client that is inconsistent with the definition used here.
.02	The term “noncompliance” is not defined within the interpretation but is used as an abbreviation in paragraph .02. The interpretation then generally, but not always, refers to “noncompliance or suspected noncompliance.” We recommend indicating in paragraph .02 that “noncompliance” includes “suspected noncompliance, where applicable.” Then the interpretation can be simplified to “noncompliance.”
.02	Paragraph .08 (scope) indicates that fraud is in the scope of this interpretation. However, it is not apparent in paragraph .02 that noncompliance includes fraud. As the auditing standards include specific guidance for fraud separate from the guidance on noncompliance, this interpretation should be clear that it covers both. We recommend clarifying in paragraph .02 that noncompliance for purposes of the interpretation includes fraud.
.19	<p>The phrase “considered necessary in the public interest” is vague and not defined. The interpretation offers no guidance on what basis the accountant is to advise management it is “necessary” to disclose a matter “in the public interest.” The language suggests there could be a circumstance where the accountant advises disclosure of the matter should be made, even if it is not legally required. If the client receives legal advice that disclosure is not required, does the accountant have an obligation to consider resignation if he or she thinks disclosure is nevertheless “necessary?”</p> <p>In contrast, paragraph .27 lists considerations to be evaluated in determining whether resignation is warranted, among the considerations is whether there is evidence of “actual or potential substantial harm to the interests of the entity, investors, creditors, employees, or the general public.” This is a clearer standard and identifies a specific circumstance in which disclosure could be an appropriate response to the matter. Using this as a more objective criterion upon which to base a conclusion that disclosure is “necessary in the public interest” would make the guidance in paragraph .19 more useful.</p>

Paragraph	Suggested Revision	Rationale
.19	In discussing the noncompliance or suspected noncompliance with management and, when appropriate, those charged with governance, the member should advise them <u>the engaging party</u> to take the following appropriate and timely actions, if they have not already done so:	To clarify who the member should advise. Also, see observation above in regard to the use of ‘engaging party’ rather than ‘client.’
.22	If the member becomes aware of noncompliance or suspected noncompliance, the member should, in addition to responding to the matter in accordance with the provisions of this section, communicate at <u>the noncompliance or suspected noncompliance</u> to the group audit partner in accordance with AU-C section 600, Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors).	To clarify what is communicated.
.34	Such discussion serves to clarify the member’s understanding of the facts and circumstances relevant to the matter and its potential consequences. The discussion also may prompt management or those charged with governance to investigate the matter.	The interpretation should not presume to imply how management may respond.
.36	The communication should be made in accordance with the firm’s protocols or procedures or, in the absence of such protocols and procedures, directly to the <u>financial statement attest engagement partner</u> .	To clarify to which engagement partner the communication should be made.
.37	If the communication is made, it should be made in accordance with the network's protocols or procedures or, in the absence of such protocols and procedures, directly to the <u>financial statement attest engagement partner</u> .	To clarify to which engagement partner the communication should be made.
.38	In all cases, the communication is to enable the <u>financial statement attest engagement partner</u> to be informed about the noncompliance or suspected noncompliance and to determine whether it should be addressed in accordance with the provisions of this interpretation and, if so, how.	To clarify to which engagement partner the communication should be made.