



Agenda Item 3A

NONCOMPLIANCE WITH LAWS AND REGULATIONS (NOCLAR): PROJECT PROPOSAL FOR NARROW REVISION OF AUDITING STANDARDS

I. Subject

This project proposal addresses potential revision to auditing standards generally accepted in the United States of America to require communication to successor auditors if the predecessor auditor withdraws from an engagement or decides not to stand for reappointment and NOCLAR has been identified. The requirement would also apply when the auditor is terminated by the client. The following AU-C sections may be impacted:

- AU-C section 210, *Terms of Engagement*,
- AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, and
- AU-C section 510, *Opening Balances – Initial Audit Engagements, Including Reaudit Engagements*

The proposed project is intended to be narrow in scope and not a full convergence project.

II. Background, How the Project Serves the Public Interest, Project Objectives and Scope

Background

The 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 noncompliance with laws or regulation (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 NOCLAR without client or employer consent.

In response to the 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. NASBA recommended “tabling this project until such time as UAA (Uniform Accountancy Act) language is developed to incorporate NOCLAR requirements”.

Based on NASBA’s response and other concerns, the PEEC did not adopt the proposed interpretations. A joint task force of the AICPA and NASBA was set up to deliberate whether the UAA should permit accountants (when warranted) to divulge NOCLAR to an outside party without employer or client consent. That task force has met several times in 2019.

AICPA Code of Professional Conduct

The extant “Confidential Client Information Rule” (1.700.001) of the AICPA Code prohibits members in public practice from disclosing confidential client information without specific consent of the client (except in limited circumstances) and thus would not permit disclosure of a NOCLAR. One of the limited circumstances in which the AICPA Code allows disclosure of confidential client information without specific client consent is when the member is required to do so as part of their professional obligations of the “Compliance With Standards Rule” (1.310.001).

PEEC Request of ASB

As an option to further address NOCLAR, the PEEC requests that the ASB consider revisions to GAAS to require communication to successor auditors of a former client when NOCLAR has been identified 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 is not requesting that the ASB consider revisions to GAAS that would require auditors to report NOCLAR to other outside parties, such as the appropriate authorities.

How the Project Serves the Public Interest

The most significant public interest issues the ASB will address include:

- Increasing transparency to the potential successor auditor with respect to circumstances that may be relevant for evaluating whether to accept the engagement
- Decreasing the risk that NOCLAR would be obscured by a change in auditors

Project Objectives

The project objectives are to propose revisions to GAAS to require communication to successor auditors when NOCLAR has been identified. While the working group has not yet determined the extent of the appropriate proposed revisions the following represents a listing of paragraphs in GAAS that reference communications between predecessor and successor auditors with respect to NOCLAR:

Paragraph .A31 of AU-C section 210, *Terms of Engagement*

.A31 The communication with the predecessor auditor may be either written or oral. Matters subject to the auditor's inquiry of the predecessor auditor may include the following:

- Information that might bear on the integrity of management
- Disagreements with management about accounting policies, auditing procedures, or other similarly significant matters
- Communications to those charged with governance regarding fraud and noncompliance with laws or regulations by the entity
- Communications to management and those charged with governance regarding significant deficiencies and material weaknesses in internal control
- The predecessor auditor's understanding about the reasons for the change of auditors

Paragraph .A28 of AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

.A28 The auditor's professional duty to maintain the confidentiality of client information may preclude reporting identified or suspected noncompliance with laws and regulations to a party outside the entity. However, the auditor's legal responsibilities vary by jurisdiction, and in certain circumstances, the duty of confidentiality may be overridden by statute, the law, or courts of law. In the following circumstances, a duty to notify parties outside the entity may exist:

- In response to inquiries from an auditor to a predecessor auditor, in accordance with the requirements of [section 210](#), *Terms of Engagement*^{fn 16}
- In response to a court order
- In compliance with requirements for the audits of entities that receive financial assistance from a government agency

Because potential conflicts with the auditor’s ethical and legal obligations for confidentiality may be complex, the auditor may consult with legal counsel before discussing noncompliance with parties outside the entity.

Project Scope

It is intended that the scope of this proposed project would be narrow and would not include other potential changes that may be considered as part of a future project specific to convergence with ISA 250.

Implications for Any Specific Persons or Groups

The project has implications for NASBA, state boards of accountancy, PEEC, and all CPAs who perform audits in accordance with GAAS.

Development Process, Project Timetable and Project Output

A working group was formed consisting of ASB members Harry Cohen and Gaylen Hansen for the purpose of developing this project proposal. A conference call has been held between the working group, PEEC staff, as well as the ASB Chair and AICPA Chief Auditor to initially discuss this project. The working group is staffed by Mike Glynn. Additional resources will be added to the working group and formation of a task force will take place if this project proposal is approved.

Subject to the AITF’s approval of this project proposal, the following sets out a preliminary timetable, noting that specific project milestones and outputs may change as the project develops.

September 4, 2019 – Initial discussion of project with AITF and approval to proceed with project proposal

October 2019 – Project introduced to ASB during the October 2019 ASB meeting

November 2019 – Obtain the AITF’s approval of the project proposal

^{fn 16} [Paragraphs .11–.12](#) of section 210, *Terms of Engagement*.

December 6, 2019 – initial discussion of draft revisions during ASB conference call

January 2020 – Present proposed standard to ASB for consideration and vote to expose for public comment

May 2020 – consideration of comments received on public exposure and vote to finalize revisions to GAAS