



## Agenda Item 3

### NOCLAR

#### Objective of Agenda Item

To consider and vote to ballot for exposure proposed revisions to 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.

#### 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.

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.

Based on NASBA's response and other concerns, the PEEC did not adopt the proposed interpretations. 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 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 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.

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. The NOCLAR Task Force was formed and is staffed by Mike Glynn and consists of the following ASB members:

Harry Cohen (Chair)  
Lawrence Gill  
Gaylen Hansen

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.

## **Issues for Discussion with the ASB**

### *Issue 1 – Required Communication Between Predecessor and Successor Auditors*

The PEEC's request for the ASB to 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 is because paragraph 1.700.001.02 of the Code of Professional Conduct states that the Confidential Client Information Rule does not relieve a member of his or her professional obligations of the "Compliance With Standards Rule." The Task Force proposes to include requirements with respect to that communication between predecessor and successor auditors in paragraphs .12-.13 of AU-C section 210 as follows:

- .12 The auditor should inquire of the predecessor auditor about matters that will assist the auditor in determining whether to accept the engagement. The auditor should specifically inquire about: (Ref: par. A29 - .A30)*
- a. Identified or suspected fraud involving*
    - i. management,*
    - ii. employees who have significant roles in internal control, or*
    - iii. others, where the fraud results in a material misstatement in the financial statements*
  - b. Matters involving noncompliance with laws and regulations that come to the auditor's attention during the audit, other than when matters are clearly inconsequential. (Ref: par. .A31)*

- .13 ***The predecessor auditor should respond to the auditor’s inquiries promptly and to the extent permitted by applicable law, fully on the basis of known facts. (Ref: par. .A32-.A34)***

Note that the proposed communication regarding identified or suspected fraud is consistent with the requirement in paragraph .40 of AU-C section 240 and the proposed communication regarding matters involving noncompliance with laws and regulations that come to the auditor’s attention during the audit is consistent with the requirement in paragraph .21 of AU-C section 250 regarding required communications to those charged with governance.

**Action Requested of ASB**

The ASB is asked to provide feedback regarding whether it agrees with the approach proposed by the Task Force regarding the auditor’s responsibility to communicate with a successor auditor with respect to identified or suspected fraud and matters involving noncompliance with laws and regulations.

Issue 2 – Client Consent to the Auditor’s Communications

Paragraph 1.700.001.01 states that “a member in public practice shall not disclose any confidential client information without the *specific consent* of the client” (emphasis added). During its meeting in December 2019, the ASB expressed that any proposed revisions should not preclude an auditor from performing an audit in situations in which the client refuses to provide such specific consent. To address that concern, the Task Force proposes that the following new application paragraph hang off the requirement in paragraph .10 of AU-C section 210 that the engagement letter include the responsibilities of the auditor:

- .A27 As part of the responsibilities of the auditor, the auditor may include the auditor’s responsibility to communicate identified or suspected fraud and matters involving noncompliance with laws and regulations that come to the auditor’s attention during the audit to those charged with governance and to a successor auditor. The auditor may also request management’s explicit consent to communicate such matters to those charged with governance and to a successor auditor.***

**Action Requested of ASB**

The ASB is asked to provide feedback regarding whether it agrees with the approach proposed by the Task Force with respect to not requiring management’s explicit consent regarding the auditor’s responsibility to communicate with those charged with governance and a successor auditor with respect to identified or suspected fraud and matters involving noncompliance with laws and regulations while including application material that provides the auditor with an option to request such explicit consent.

Issue 3 – Documentation of Communication Between the Auditor and the Predecessor Auditor

The Task Force considered documentation requirements with respect to the proposed required communications between the auditor and the predecessor auditor with respect to identified or suspected fraud and matters involving noncompliance with laws and regulations. The Task Force

proposes a requirement consistent with paragraph .20 of AU-C section 260, *The Auditor's Communication With Those Charged With Governance* as follows:

*.14 When matters required to be communicated by paragraph .12 have been communicated orally, the auditor should include them in the audit documentation. When matters have been communicated in writing, the auditor should retain a copy of the communication as part of the audit documentation.*

**Action Requested of ASB**

The ASB is asked to provide feedback regarding whether it agrees with the proposed documentation requirement with respect to the proposed required communications between the auditor and the predecessor auditor with respect to identified or suspected fraud and matters involving noncompliance with laws and regulations.

Issue #4 – Effective Date

The proposed effective date for the revisions to AU-C section 210 is for audits of financial statements for periods ending on or after December 15, 2021. Early implementation is proposed to be permitted.

**Action Requested of ASB**

The ASB is asked to consider whether it agrees with the proposed effective date.

**Overall Action Requested of ASB**

The ASB is asked to vote to ballot the proposed SAS for public comment.

**Proposed Timeline:**

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

**Agenda Items Presented:**

Agenda Item 3A      Proposed SAS, *Communication With Predecessor Auditor Regarding Fraud and Noncompliance With Laws and Regulations*

Agenda item 3B      Proposed wrap document