



Agenda Item 3B

EXPOSURE DRAFT

PROPOSED STATEMENT ON AUDITING STANDARDS

COMMUNICATION WITH PREDECESSOR AUDITOR REGARDING FRAUD AND NONCOMPLIANCE WITH LAWS AND REGULATIONS

(Amends Statement on Auditing Standards [SAS] No. 122, Statements on Auditing Standards: Clarification and Recodification, as amended, section 210, Terms of Engagement [AICPA, Professional Standards, AU-C sec. 210])

January XX, 2020

Comments are requested by Month DD, 2020

Prepared by the AICPA Auditing Standards Board for comment from persons interested in auditing and reporting issues.

Comments should be submitted in Word format and sent to CommentLetters@aicpa-cima.com.

© 2019 American Institute of Certified Public Accountants, Inc.

Permission is granted to make copies of this work provided that such copies are for personal, intraorganizational, or educational use only and are not sold or disseminated and provided further that each copy bears the following credit line: “© 2019 American Institute of Certified Public Accountants, Inc. Used with permission.”

CONTENTS

	Page
Explanatory Memorandum	
Introduction.....	4
Background.....	4
Effective Date	5
Explanation of Proposed Changes	5
Guide for Respondents.....	7
Comment Period	7
Auditing Standards Board Members.....	8
 Exposure Draft	
Proposed Statement on Auditing Standards <i>Communication With Predecessor Auditor Regarding Fraud and Noncompliance With Laws and Regulations</i>	9

Explanatory Memorandum

Introduction

This memorandum provides background to the proposed Statement on Auditing Standards (SAS) *Communication With Predecessor Auditor Regarding Fraud and Noncompliance With Laws and Regulations*.¹ If issued as final, the proposed SAS will amend the SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as amended, section 210, *Terms of Engagement* [AICPA, *Professional Standards*, AU-C sec. 210]

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 noncompliance with laws and regulations (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 certain relevant changes as adopted 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, certain commenters expressed 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.

As an option to address certain matters with respect to NOCLAR, the ASB is considering narrow revisions to auditing standards generally accepted in the United States of America (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 take place, the ASB is not considering revisions to GAAS that would require auditors to report NOCLAR to other outside parties, such as the appropriate authorities.

¹ All AU-C sections can be found in AICPA *Professional Standards*.

Effective Date

If issued as final, the proposed amendments to AU-C section 210 will be effective for audits of financial statements for periods ending on or after December 15, 2021. Early implementation is permitted.

Explanation of Proposed Changes

The following is a summary of the proposed changes to extant AU-C section 210 that the ASB believes would be the most significant.

Proposed requirement that the auditor inquire of the predecessor auditor regarding identified or suspected fraud and matters involving noncompliance with laws and regulations

It is proposed that the following requirement be included in AU-C section 210:

- .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. A30 - .A31)***
- 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. .A28)***

The communication requirements are consistent with the communication requirements for those charged with governance as required by extant AU-C section 240, *Consideration of Fraud in a Financial Statement Audit* (paragraph .40 of AU-C section 240) and AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements* (paragraph .21 of AU-C section 250).

It is the intent of the proposed required inquiry that any knowledge of identified or suspected fraud and matters involving noncompliance with laws and regulations be passed from a predecessor to a successor auditor. This would limit the ability of a client to avoid the consequences of such matters by simply changing auditors. The proposed requirement is considered to be in the public interest.

Request for Specific Comment #1

Is the proposed requirement appropriate and complete? If not, please suggest specific revisions.

Proposed requirement that the predecessor auditor respond to the auditor's inquiries promptly and, in the absence of unusual circumstances or any law prohibiting disclosure of confidential client information to an outside party, fully on the basis of known facts

The proposed requirement would result in the predecessor auditor complying with the Code of Professional Conduct. The "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).

If the proposed requirement is included in a final SAS, it would be the only requirement included in GAAS on a predecessor auditor as all other requirements apply to the current auditor.

Request for Specific Comment #2

Is the proposed requirement appropriate and complete? If not, please suggest specific revisions.

Documentation

The proposed SAS includes the following requirement:

.14 When matters required to be communicated by paragraph .12 - .13 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.

The proposed requirement is consistent with paragraph .20 of AU-C section 260, *The Auditor's Communication With Those Charged With Governance*.

Request for Specific Comment #3

Is the proposed requirement appropriate and complete? If not, please suggest specific revisions.

Guide for Respondents

Respondents are asked to comment on the proposed changes to AU-C section 210.

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, when appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for the ASB to be made aware of this view, as well.

Written comments on the exposure draft will become part of the public record of the AICPA and will be available for public inspection at the offices of the AICPA for one year, beginning Month DD, 2020. Responses should be submitted in Word format, sent to commentletters@aicpa-cima.com, and received by Month DD, 2020. Respondents may also submit a PDF version of their response for posting to the AICPA website.

Comment Period

The comment period for this exposure draft ends Month DD, 2020.

**Auditing Standards Board
(2019–2020)**

Michael J. Santay, *Chair*
Brad C. Ames
Monique Booker
Jay D. Brodish, Jr.
Dora A. Burzenski
Joseph S. Cascio
Harry Cohen
Jeanne M. Dee
Lawrence M. Gill
Audrey A. Gramling

Gaylen R. Hansen
Tracy W. Harding
Jon Heath
Jan C. Herringer
Kristen A. Kociolek
G. Alan Long
Sara Lord
Marcia L. Marien
Aaron Saito

NOCLAR Task Force

Harry Cohen, *Chair*
Lawrence M. Gill

Gaylen R. Hansen

AICPA Staff

Robert Dohrer, CPA, CGMA
Chief Auditor
Professional Standards and Services

Teighlor S. March
Assistant General Counsel

Michael P. Glynn
Senior Manager
Audit and Attest Standards — Public
Accounting