



## Agenda Item 1

### NOCLAR

#### Objective of Agenda Item

To vote to expose for public comment the proposed revisions to AU-C section 210, *Terms of Engagement* to require a prospective successor auditor, once management authorizes the predecessor auditor to respond to inquiries from the prospective successor auditor, to inquire of the predecessor auditor regarding identified or suspected fraud or noncompliance with laws or regulation (NOCLAR).

#### NOCLAR Task Force

Harry Cohen – Task Force Chair and current ASB Member

Dan Dustin – National Association of State Boards of Accountancy (NASBA)

Lawrence Gill – Former ASB Member

Gaylen Hansen – Former ASB Member

Bill Mann – Immediate past member of the Professional Ethics Executive Committee (PEEC) and General Counsel and National Director of Independence at Mayer Hoffman McCann, PC

The Task Force is staffed by Mike Glynn.

#### Background

The International Ethics Standards Board for Accountants (IESBA) Code of Ethics for Professional Accountants (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 where necessary in the public interest, even if not required by law.

In 2016, the International Audit and Assurance Standards Board (IAASB) revised ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, to reflect the changes in the IESBA code.

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." Although similar to the IESBA's code, the exposure draft explained that certain differences were necessary to enhance the clarity of the proposed interpretations and make them relevant to AICPA members in the United States. Most notably certain provisions were not

included in the AICPA proposals because they were believed to be incompatible with most state laws and regulations on client and employer confidentiality. The AICPA Code of Professional Conduct (AICPA code) does not permit a CPA to disclose confidential client information without client or employer consent unless required by professional standards. The following is the applicable excerpt from the AICPA code:

**1.700.001 Confidential Client Information Rule**

.01 *A member in public practice shall not disclose any confidential client information without the specific consent of the client.*

.02 This rule shall not be construed (1) to relieve a *member* of his or her professional obligations of the “Compliance With Standards Rule” [1.310.001] or the “Accounting Principles Rule” [1.320.001].

In response to the PEEC exposure draft, comments were received expressing concern that the proposed language would discourage CPAs from acting in the public interest even after the CPA demonstrated compliance with all relevant professional standards.

A project proposal was developed and presented to the Audit Issues Task Force (AITF) in November 2019. The stated objective was to propose revisions to GAAS to require communication to successor auditors when NOCLAR has been identified. The AITF approved the project proposal as presented and the NOCLAR Task Force was formed.

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.

At its meeting in January 2020, the ASB considered proposed revisions to AU-C section 210. The ASB supported the Task Force’s proposed approach regarding the predecessor auditor’s responsibility to communicate with a successor auditor with respect to identified or suspected fraud and matters involving NOCLAR. The ASB believed that it is in the public interest for a knowledge transfer from the predecessor auditor to the successor auditor to take place with respect to identified or suspected fraud and matters involving NOCLAR. Further, the Board was opposed to an approach that would require client consent beyond that already required by paragraph .11 of AU-C section 210.

The Task Force provided an update at the July 2020 ASB meeting and presented a draft of the proposed amendments and requested ASB feedback.

The Task Force presented a draft of the proposed amendments to the ASB at the ASB’s October 2020 meeting with a request that the ASB vote to expose the proposed amendments for public comment. The ASB considered the proposed amendments but did not vote as scheduled to issue the proposed amendments for exposure to allow for further research and discussion with stakeholders.

***Current Proposal***

The ASB has directed retention of the requirement that the successor auditor request management to authorize the predecessor auditor to respond fully to the successor auditor's inquiries regarding matters that will assist the successor auditor in determining whether to accept the engagement. However, as an option to address identified or suspected fraud and matters involving NOCLAR, the proposed revisions would narrowly revise GAAS to require a successor auditor, once management authorizes the predecessor auditor to respond to inquiries from the successor auditor, to inquire of the predecessor auditor regarding identified or suspected fraud and matters involving NOCLAR. This approach is similar to the approach included in the Public Company Auditing Oversight Board's AS 2610, *Initial Audits – Communications Between Predecessor and Successor Auditors* that directs the successor auditor to make more specific inquiries of the predecessor auditor after requesting permission from the prospective client to make an inquiry of the predecessor auditor. Furthermore, the absence of authorization for a potential successor auditor to make inquiries of a predecessor auditor should give rise to sufficient questions from the prospective successor auditor with respect to engagement acceptance irrespective of the basis for the lack of authorization. Further revisions to GAAS that would require auditors to report fraud or NOCLAR to other outside parties, such as the appropriate authorities, are not proposed.

#### ***Information Received From NASBA***

At its January 2020 meeting, the ASB was presented with information from NASBA that initially indicated, without explicit client consent, state laws and regulations in only 8 jurisdictions may permit a predecessor auditor to respond to a successor auditor's inquiries with respect to identified or suspected fraud and matters involving NOCLAR that come to the auditor's attention during the audit. With this information, the ASB expressed concern that the Board's understanding of the current state of local laws and regulations coupled with an absence of a requirement for the auditor to obtain the client's explicit consent to such communications prior to commencing the audit, the proposed standard would not accomplish the intended knowledge transfer between the predecessor and successor auditors. Subsequent to the January 2020 meeting, it was determined that this analysis did not contemplate GAAS requiring such communications and thus did not contemplate the "compliance with standards" provision of Section 18 of the Uniform Accountancy Act (UAA). Section 18 of the UAA reads as follows (*emphasis added*):

#### CONFIDENTIAL COMMUNICATIONS

Except by permission of the client for whom a licensee performs services or the heirs, successors, or personal representatives of such client, a licensee under this Act, shall not voluntarily disclose information communicated to the licensee by the client relating to and in connection with services rendered to the client by the licensee. Such information shall be deemed confidential, provided, ***however, that nothing herein shall be construed as prohibiting the disclosure of information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements*** or as prohibiting compliance with applicable laws, government regulations or PCAOB requirements, disclosures in court proceedings, in investigations or proceedings under Sections 11 or 12 of this Act, in ethical investigations conducted by private professional organizations, or in the course of peer reviews, or to other persons active in the organization performing services for that client on a need to know basis or to persons in the entity who need this information for the sole purpose of assuring quality control.

At the request of AICPA staff, NASBA subsequently reperformed the research with the research assuming a GAAS requirement existed for such communications and determined that 52 of 55 jurisdictions would permit the communication between predecessor and successor auditors. The remaining 3 jurisdictions may also allow the communication subject to further interpretation of their laws and rules. The NOCLAR Task Force believes that this new evaluation and information sufficiently alleviates the initial concerns raised by the ASB at its January 2020 meeting.

## **Discussion with the ASB**

**Mr. Cohen will use agenda item 1A to walk the ASB through the proposed amendments to AT-C section 210.** After discussion, the ASB will be asked to vote to ballot to expose the proposed amendments for public comment.

The base of agenda item 1A is the clean draft presented as part of the October 2020 agenda material. The changes to that draft are color coded for ease of ASB review:

- The revisions proposed by the AICPA Editorial Team are in purple. Those revisions were discussed by the ASB during its meeting in October 2020.
- All revisions made by the Task Force to the October 2020 agenda draft are in green. As a revised draft was presented to the ASB during the course of the October 2020 meeting, those changes made subsequent to the draft that was discussed at the meeting are yellow highlighted. Such changes were made to address ASB member comments expressed during that second discussion of the draft in October 2020, to address ASB member concerns communicated to the Task Force subsequent to that last discussion, or pursuant to additional Task Force consideration.

The Task Force proposes that the comment period end in mid-April 2021 so that the Task Force can consider and summarize the comments received for ASB consideration at its meeting in May 2021.

## **Issues for Discussion with ASB**

### **Definition of *successor auditor***

At various points during the Task Force's discussions with the ASB, the Board expressed concern that the references to *auditor* in extant AU-C section 210 were potentially confusing to readers of the standard. To address that concern, the Task Force had proposed an application paragraph that stated, for the purposes of the paragraphs addressing the communications with the predecessor auditor, that the term *auditor* referred to the successor auditor. The ASB directed, instead, that (*successor*) be added in front of all references to *auditor* that were meant to refer to the successor auditor.

To further clarify, the Task Force proposes a new defined term as follows:

**Successor auditor.** An auditor who is considering accepting an engagement to audit financial statements but has not communicated with the predecessor auditor as provided

in paragraphs .11 through .14, as well as an auditor who has accepted such an engagement.

The proposed definition is consistent with paragraph .12 of the PCAOB's AS 2610, *Initial Audits – Communications Between Predecessor and Successor Auditors*.

**Agenda Items Presented:**

Agenda item 1A Draft exposure draft of the proposed SAS, *Inquiries of the Predecessor Auditor Regarding Fraud and Noncompliance With Laws and Regulations* – redline to show changes from clean draft included in the agenda material for the ASB's October 2020 meeting

Agenda item 1B Draft exposure draft of the proposed SAS, *Inquiries of the Predecessor Auditor Regarding Fraud and Noncompliance With Laws and Regulations* – clean

Note – as the draft amendments are presented in ***boldface italics*** and ~~strikethrough~~, agenda item 1B (the clean draft) effectively serves as a markup from extant AU-C section 210.