



Agenda Item 1

Issues Paper: Communications with Predecessor Accountants

Objective of Agenda Item

To discuss issues with respect to communications with a predecessor accountant in connection with acceptance of a review engagement and to consider elevating the authoritative guidance contained in the Guide, *Preparation, Compilation, and Review Engagements* (the Guide) to requirements/guidance in AR-C section 90, *Review of Financial Statements*.

Background

Unlike auditing standards generally accepted in the United States of America (GAAS), Statements on Standards for Accounting and Review Services (SSARSs) do not require an accountant to communicate with a predecessor accountant in connection with acceptance of a review engagement.

SSARS 4, *Communications Between Predecessor and Successor Accountants* was issued in December 1981. The last amended version (through SSARS 17) is available at <https://www.aicpa.org/content/dam/aicpa/research/standards/compilationreview/downloadabledocuments/ar-00400.pdf>. All of the requirements in AR section 400 were conditional as the first sentence of paragraph .01 of AR section 400 read (*emphasis added*) “This section provides guidance on communications between a predecessor and successor accountant *when the successor accountant decides to communicate with the predecessor accountant* regarding acceptance of an engagement to compile or review the financial statements of a nonissuer.” Further, paragraph .03 of AR section 400 stated “A successor accountant is not required to communicate with a predecessor accountant in connection with acceptance of a compilation or review engagement, but he or she may believe it is beneficial to obtain information that will assist in determining whether to accept the engagement.”

In October 2014, the ARSC issued SSARS 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification*. SSARS 21 represented the ARSC’s efforts to clarify and revise the existing standards for reviews, compilations, and engagements to prepare financial statements. SSARS 21 superseded all existing AR sections in AICPA Professional Standards (including AR section 400) with the exception of AR section 120, *Compilation of Pro Forma Financial Information*.

In January 2016, the ARSC considered the AR literature and how the requirements and guidance were disposed – that is, either included in SSARS 21, the Guide, or not included in authoritative literature – and whether any interpretative guidance or requirements should be retained. AR

section 400 and the one interpretation to that section were included in that consideration. The matrix that the ARSC utilized as part of its consideration of the requirements in AR section 400 is available at

<https://www.aicpa.org/content/dam/aicpa/research/standards/compilationreview/arsc/documents/201601-item1e.pdf>.

At the January 2016 meeting, while recognizing that the SSARs have never required that a successor accountant communicate with a predecessor accountant, a point was raised that the ARSC consider, as a future project, requiring communications between successor and predecessor accountants in a review engagement and that such requirements could be modeled after the requirements for an audit engagement. The ARSC determined that there was not an immediate need to issue any additional requirements, guidance, or interpretations to AR-C sections 70, 80, or 90. The highlights from that meeting are available at

<https://www.aicpa.org/content/dam/aicpa/research/standards/compilationreview/arsc/documents/201601-arsc-meeting-highlights.pdf>.

Subsequently, the ARSC determined it appropriate to include the following guidance in the Guide:

Communications With Predecessor Accountants

- 1.31** SSARs do not require a successor accountant to communicate with a predecessor accountant in connection with acceptance of a review engagement, but he or she may believe it is beneficial to obtain information that will assist in determining whether to accept the engagement. The successor accountant may consider making inquiries of the predecessor accountant when circumstances such as the following exist:
- a. The information obtained about the prospective client and its management and principals is limited or appears to require special attention.
 - b. The change in accountants takes place substantially after the end of the accounting period for which statements are to be reviewed.
 - c. There have been frequent changes in accountants.

The predecessor accountant and the prospective client may have disagreed about accounting principles, procedures applied by the predecessor accountant, or similarly significant matters.

- 1.32** Except as permitted by the AICPA Code of Professional Conduct, an accountant is precluded from disclosing any confidential information obtained in the course of an engagement unless the client specifically consents. Accordingly, if the successor accountant decides to communicate with the predecessor, it is important that the successor accountant request the client to (a) permit the successor accountant to make inquiries of the predecessor accountant and (b) authorize the predecessor accountant to respond fully to those inquiries. If the prospective client refuses to

permit the predecessor accountant to respond or limits the response, the successor accountant may want to inquire about the reasons and consider the implications of that refusal in connection with acceptance of the engagement.

1.33 When the successor accountant decides to communicate with the predecessor accountant, the inquiries may be oral or written. The inquiries are most useful if they are specific and reasonable regarding matters that will assist the successor accountant in determining whether to accept the engagement. Matters subject to inquiry would include (a) information that might bear on the integrity of management (owners), (b) disagreements with management (owners) about accounting principles or the necessity for the performance of certain procedures or similarly significant matters, (c) the cooperation of management (owners) in providing additional or revised information, if necessary, (d) the predecessor’s knowledge of any fraud or illegal acts perpetrated within the client, and (e) the predecessor’s understanding of the reason for the change of accountants.

1.34 It is considered good practice for the predecessor accountant to respond promptly and fully to the inquiries, on the basis of known facts. However, the predecessor accountant may decide, due to unusual circumstances such as impending, threatened, or potential litigation; disciplinary proceedings; or other unusual circumstances, to not respond fully to the inquiries and instead indicate that the response is limited. A limited response may have implications in connection with acceptance of the engagement.

At its meeting in January 2020, the ARSC stated that it is in the public interest and would positively impact the quality of review engagements if certain knowledge is transferred from a predecessor to a successor accountant. Certain members of the profession have expressed the belief that, post SSARS 25, the standards for nonaudit services are substantially appropriate and it would be a welcome relief to accountants performing such services if few SSARSs were issued over the next few years. If the ARSC were to undergo a standard-setting project, the substance would be the elevation of guidance in the authoritative Guide to a requirement in AR-C section 90 and thus would not be entirely unfamiliar to accountants performing review engagements.

If the ARSC were to elevate the authoritative guidance contained in the Guide to AR-C section 90 using the requirements and guidance in AU-C section 210, *Terms of Engagement* as a base, such requirements and guidance could read as follows (additions and deletions to the language in AU-C section 210 are show in ***boldface italics*** and ~~strikethrough~~, respectively).

Initial Audits, Including Reaudit Engagements Reviews	Initial Audits, Including Reaudit Engagements Reviews (Ref: par. .11 <i>.12.14</i>)
.11/3 Before accepting an engagement for an initial audit review , including a reaudit engagement, the auditor <i>accountant</i> should request management to authorize the predecessor auditor <i>accountant</i> to respond	

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<p>fully to the auditor's <i>accountant's</i> inquiries regarding matters that will assist the auditor <i>accountant</i> in determining whether to accept the engagement. If management refuses to authorize the predecessor auditor <i>accountant</i> to respond, or limits the response, the auditor <i>accountant</i> should inquire about the reasons and consider the implications of that refusal in deciding whether to accept the engagement.</p>	
<p>.1214 The auditor <i>accountant</i> should evaluate the predecessor auditor's <i>accountant's</i> response, or consider the implications if the predecessor auditor <i>accountant</i> provides no response or a limited response, in determining whether to accept the engagement. (Ref: par. .A29 - .A34. <i>A24 - .A28</i>)</p>	<p>.A29A24 An auditor <i>accountant</i> may make a proposal for an audit <i>a review</i> engagement before being granted permission to make inquiries of a predecessor auditor <i>accountant</i>. The auditor <i>accountant</i> may advise management in the proposal or otherwise that the auditor's <i>accountant's</i> acceptance of the engagement cannot be final until the inquiries have been made and the responses of the predecessor auditor <i>accountant</i> have been evaluated.</p> <p>.A30A25 When more than one auditor <i>accountant</i> is considering accepting an engagement, the predecessor auditor <i>accountant</i> is not expected to be available to respond to inquiries until an auditor <i>accountant</i> has been selected by the entity and has accepted the engagement, subject to the evaluation of the communications with the predecessor auditor <i>accountant</i> as provided in paragraph .1214.</p> <p>.A31A26 Relevant ethical and professional requirements guide the auditor's <i>accountant's</i> communications with the predecessor auditor <i>accountant</i> and management, as well as the predecessor auditor's <i>accountant's</i> response. Such requirements provide that, except as permitted by the rules of the AICPA Code of Professional Conduct, an auditor <i>accountant</i> is precluded from disclosing confidential information obtained in the course of an engagement unless management specifically consents. Such <i>Relevant ethical and professional</i> requirements also provide that both the auditor <i>accountant</i> and the</p>

predecessor ~~auditor~~ **accountant** hold in confidence information obtained from each other. This obligation applies regardless of whether the ~~auditor~~ **accountant** accepts the engagement.

~~.A32~~A27 In accordance with the AICPA Code of Professional Conduct, which states that members have a responsibility to cooperate with each other, the predecessor ~~auditor~~ **accountant** is expected to respond to the ~~auditor's~~ **accountant's** inquiries promptly and, in the absence of unusual circumstances, fully, on the basis of known facts. If, due to unusual circumstances, such as pending, threatened, or potential litigation; disciplinary proceedings; or other unusual circumstances, the predecessor ~~auditor~~ **accountant** decides not to respond fully to the inquiries, the predecessor ~~auditor~~ **accountant** is expected to clearly state that the response is limited.

~~.A33~~A28 The communication with the predecessor ~~auditor~~ **accountant** may be either written or oral. Matters subject to the ~~auditor's~~ **accountant's** inquiry of the predecessor ~~auditor~~ **accountant** may include the following:

- Information that might bear on the integrity of management
- Disagreements with management about accounting policies, auditing *or review* 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, *if applicable*

- The predecessor auditor's *accountant's* understanding about the reasons for the change of ~~auditors~~ *accountants*
- The predecessor auditor's *accountant's* understanding of the nature of the entity's relationships and transactions with related parties and significant unusual transactions

~~*Considerations Specific to Governmental Entities*~~

~~A34~~ When the auditor is required by law or regulation to audit a governmental entity, inquiries of the predecessor auditor for the purpose of obtaining information about whether to accept the engagement may not be relevant. However, inquiries of the predecessor auditor may still be relevant for the purpose of obtaining information that is used by the auditor in planning and performing the audit.^{fn13}

^{fn13} Section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*, addresses the auditor's responsibilities relating to opening balances when conducting an initial audit engagement.

In addition, the term *predecessor accountant* would need to be defined. The following reflects the edits proposed to the definition of *predecessor auditor* in the auditing standards:

Predecessor ~~auditor~~ accountant. The ~~auditor~~ *accountant* from a different ~~audit~~ firm who has reported on the most recent audited *or reviewed* financial statements or was engaged to perform but did not complete an audit *or review* of financial statements.

The term *successor auditor* is not defined in the auditing literature.

Action Requested of ARSC

The ARSC is asked to consider whether the authoritative guidance contained in the Guide should be elevated to requirements/guidance in AR-C section 90.

No Additional Agenda Items Presented