



National Association of State Boards of Accountancy

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Professional Ethics Executive Committee
c/o Lisa A. Snyder, Director
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Via e-mail: lsnyder@aicpa.org

Re: **RESPONDING TO NON-COMPLIANCE WITH LAWS AND REGULATIONS**

Dear Members and Staff of the AICPA Professional Ethics Executive Committee (PEEC):

We appreciate the opportunity to offer comments on the Exposure Draft referred to and believe it is significant for all certified public accountants. The National Association of State Boards of Accountancy's (NASBA) mission is to enhance the effectiveness and advance the common interests of the Boards of Accountancy that regulate all certified public accountants and their firms in the United States and its territories. In furtherance of that objective, we offer the following comments on the Exposure Draft and request an extension of the exposure period.

BACKGROUND

Efforts and guidance like those of the International Ethics Standards Board for Accountants (IESBA) addressing the responsibility of accountants to appropriately inform responsible third parties of non-compliance with laws and regulations (NOCLAR) are in the public interest. This is a critical concept, especially in light of the public's increased demands for greater transparency, heightened expectations of professional behavior after numerous accounting scandals and financial crises, and attacks on the efficacy of professional regulation. We previously have commented publicly about NOCLAR, however it is unclear whether our regulatory views have been sufficiently considered as interpretations have evolved. Overall, we believe the Professional Ethics Executive Committee or, if appropriate, the AICPA/NASBA Uniform Accountancy Act Committee, has additional work to do to address NOCLAR in the U.S. with the rigor contained in the international guidance. We recognize the litigious environment within the United States as well as the regulatory structures peculiar to this country make it necessary for the guidance developed by IESBA to be tailored to the current domestic landscape, but it contains some critical elements that should not be discarded.

Since the AICPA Code of Professional Conduct does not currently address guidance on NOCLAR, the proposed interpretations will significantly impact the U.S. accounting profession and may, in

fact, belong in state law rather than the Code. Thus, we are providing the following comments which are focused on ensuring the public interest is appropriately addressed. We understand some of these matters have been previously raised in PEEC meetings by NASBA representatives, but we cannot leave them unresolved.

GENERAL COMMENTS

Overall, we have significant concerns that the proposed language will effectively discourage CPAs from acting in the public interest even after care has been taken to comply with all relevant professional standards. If CPAs withhold knowledge that otherwise could have prevented or brought to light an act in a timely manner so as to prevent public harm from occurring or continuing to occur, it will not reflect well on the worth of the profession.

Furthermore, we are concerned that the proposed interpretations will be construed as limiting or prohibiting any NOCLAR disclosure absent written client consent, even though many states have also adopted by reference the AICPA Code of Professional Conduct.

State Boards' requirements are closely tied to the Uniform Accountancy Act (UAA) and the AICPA Code of Conduct's approach to confidentiality. Consequently, to ensure the final interpretations are applied in the way which best serves the public interest, the AICPA Code of Conduct and the UAA may need to reconsider the application of confidentiality. We note that confidentiality is not regarded as a fundamental principal in the extant AICPA Code of Conduct. Moreover it is not regarded in any manner in either the SEC or PCAOB rules or regulations.

We seriously question the notion that confidentiality is preeminent to the degree that it must override all other ethical considerations, especially when public protection is threatened. We know that the confidentiality issue was brought to the attention of the AICPA/NASBA UAA Committee in 2012, at which point it was decided to wait for the IESBA's final NOCLAR standard to provide direction to the law proposed for the UAA. Consequently, we recommend tabling this project until such time as UAA language is developed to incorporate NOCLAR requirements.

EXPLANATION FOR THE NEW INTERPRETATIONS

A - PURPOSE

As the rationale for not embracing the IESBA's conclusions on exceptions to confidentiality, the prefatory material points to state laws. On page 6, PEEC states that "...certain provisions were not included in the AICPA proposals as they would be incompatible with *most state laws and regulations* on client and employer confidentiality." This is a circular argument because, as noted above, most state laws and regulations draw on the AICPA Code of Conduct and it is in the purview of the PEEC to modify, when appropriate, that same code. Changes in the business and regulatory environment, as IESBA concluded, may warrant reconsideration of existing laws and, to that end, open discussion with the State Boards.

B - CONFIDENTIALITY

On page 7, PEEC explanation states that, "...most state boards of accountancy have laws or regulations that would prohibit the disclosure of confidential client or employer information without the client or employer's consent unless required by law or regulation." Again, this is a circular argument as noted in the observation to the prior bullet.

TEXT OF PROPOSED NEW INTERPRETATION

A - INTRODUCTION

On page 11, section 1.170.010.04 states that "some regulators, such as the SEC or state boards of accountancy, may have regulatory provisions governing how a member should address non-compliance or suspected non-compliance..." It is not clear whether "provisions" include voluntarily reporting programs developed within recent years such as hotlines and whistleblowing provisions (e.g. SEC regulation 240-21F, *Securities Whistleblower Incentives and Protection*). The proposed interpretations should also reference PCAOB requirements for auditors to consider fraud in financial statements (e.g., AS 2401, *Consideration of Fraud in a Financial Statement Audit*, especially paragraphs .81A-.82). Again, it may be time for more consideration of how these efforts should be integrated to provide better public protection while avoiding creating risks to professionals for doing the right thing.

B - SCOPE

On page 13, section 1.700.010.09 contains the concept of "clearly inconsequential" as a safe harbor for not reporting NOCLAR. The definition of "clearly inconsequential" should be further defined, or the paragraph should be deleted because we do not agree that there should be any exceptions for reporting of NOCLAR and, especially, fraud. We can envision a pattern of annual "inconsequential" activities building in time to consequential matters. Further, some matters appearing inconsequential may be indicators of more serious underlying problems. We believe responsible audit committees and those charged with governance are concerned with all illegal acts as a matter of tone at the top.

In addition, we believe that leaving the concept of "clearly inconsequential" as a safe harbor for not reporting NOCLAR will place the NOCLAR section of the Code of Professional Conduct in direct conflict with the Codification of Statements on Auditing Standards . Paragraph.39 of the Code, "Communications with Management and Those Charged with Management" of the Codification provides: " If an auditor has identified a fraud or has obtained information that a fraud may exist, the auditor should communicate these matters on a timely basis to the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of the matters relevant to their responsibilities." The Codification does not include safe harbor for not reporting frauds that exist or may exist if they are deemed to be "clearly inconsequential."

These comments would also apply to Section 2.170.010.09.

C - OBTAINING AN UNDERSTANDING OF THE MATTER

On page 14, section 1700.010.14 uses the term “professional body” as a resource that a member may consult with regarding NOCLAR. The term “regulator” which is used in section 1700.010.30 is omitted in section 1700.010.14, and should also be included here. It is not clear what another “professional body” besides a “regulator” might be. A definition of “professional body” should be included if retained in the final standard.

D - COMMUNICATING THE MATTER TO THE CLIENT’S AUDITOR

- (i) On page 18, sections 1.700.010.31 and .32 include references to the financial statement audit or review. This seems inconsistent with the language used on page 8, “Group Attest Engagements” and in section 1700.010.22.a, “Communication with Respect to Group Attest Engagements,” which refers to “attest” engagements.
- (ii) On page 18, section 1.700.010.33 indicates that “except as required by law or regulation, the member is not permitted to communicate.....to the *firm* that is the *client’s* external auditor.” On page 8 under the “Communications to Client’s Auditor” it indicates “the member would be *prohibited* from communicating the NOCLAR to the external auditor.”

We have concerns that the above language may discourage CPAs from acting in the public interest. Thus, we believe that the phrase “would be prohibited from” should be deleted. The member should make the client aware of NOCLAR, however, the member should not be prohibited from communicating the matter to the client’s auditor without the client’s permission. It is in the public interest to communicate NOCLAR to the client’s auditor, even if the matter is not required to be communicated to regulatory authorities. Such communication is a responsibility in the public interest and should not be framed as a breach of confidentiality.

TEXT APPLICABLE TO ALL MEMBERS IN PUBLIC PRACTICE

A - ADDRESSING THE MATTER

On page 24, section 2.170.10.18 outlines responsibilities for addressing NOCLAR for senior professional accountants. While we agree that senior professional accountants have a higher accountability for addressing NOCLAR in the organization they serve, we believe that the word “senior” should be deleted from paragraph 2.170.10.18 as the actions in this paragraph should be applicable to all professional accountants who are responsible for reporting up the chain.

COMMENTS ON SPECIFIC QUESTIONS

We understand in developing the proposed interpretations for the United States, PEEC considered the IESBA’s NOCLAR standards and now only seeks public feedback on the following two

relatively minor questions. While we believe there are more basic issues involved in a responsible approach to NOCLAR as detailed above, we respond:

1. *Should members in public practice who provide only nonattest services to a client be required to document certain aspects of the NOCLAR? Or, rather, should they be encouraged to document certain aspects of the NOCLAR?*

We believe members in public practice who provide only nonattest services to a client should be required to document certain aspects of the NOCLAR

2. *Is a one year transition period for the effective date appropriate? If not, what is an appropriate time period and why?*

We believe the exposure draft is not ready to be considered for implementation as it stands at this time. It remains to be determined if this issue should be covered in the Uniform Accountancy Act. Should the decision be that only an interpretation is required, then once it is redrafted covering the points mentioned, it should be effective upon issuance in order to protect the public interest.

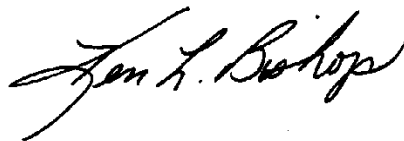
NASBA has been encouraging all State Boards of Accountancy to adopt the AICPA Code of Professional Conduct with the goal of having consistent uniform standards in all jurisdictions. Anything that might cause them to carve out provisions because such provisions are not considered to be in the public interest should be avoided.

Again, we appreciate the opportunity to comment on the Exposure Draft, however significant additional consideration of NOCLAR guidance is needed prior to issuance of a final document. We therefore suggest that PEEC table this project until the matters raised above are sufficiently addressed and are brought back to the joint UAA Committee for appropriate action.

Very truly yours,



Telford A. Lodden, CPA
NASBA Chair



Ken L. Bishop
NASBA President and CEO