



September 1, 2022

Ms. Toni Lee-Andrews
Director, Professional Ethics Division
AICPA Professional Ethics Executive Committee
1345 Avenue of the Americas, 27th Floor
New York, NY 10105

Re: AICPA Professional Ethics Executive Committee, Proposed new and revised definitions and interpretations, Compliance audits

Dear Ms. Lee-Andrews:

PricewaterhouseCoopers LLP appreciates the opportunity to provide comments on the AICPA Professional Ethics Executive Committee's (the PEEC or the "Committee") proposed new and revised definitions and interpretations (the "proposed revisions") of the AICPA *Code of Professional Conduct* (the "Code of Conduct") that address the independence requirements for compliance audits performed under the AICPA Statements on Auditing Standards.

We agree with the PEEC's proposal to clarify the independence requirements applicable to compliance audits and align the requirements with the applicable threats to independence. We also support the changes proposed by the Committee to establish a limited exemption from compliance with ET section 1.200.001 (the "Independence Rule") and its interpretations with respect to: (1) entities that report trivial and clearly inconsequential amounts on the reporting entity's schedule or statement and are not subject to the member's compliance audit procedures, and (2) affiliates of entities that meet the proposed definition of a "compliance audit attest client." We agree with the Committee that the proposed approach appropriately considers the threats to the member's objectivity and impartiality created by interests in and relationships with those entities that are in scope of the limited exemption. However, as described further in Appendix A, we recommend that the PEEC align the proposed definition of a "compliance audit" with the definition used in AU-C section 935, *Compliance Audits*, paragraph 11.

Appendix A offers our detailed comments and recommendations. Appendix B includes our specific responses to the supplementary questions in the exposure draft.

* * * * *

We would be pleased to discuss our comments and to answer any questions that you or the PEEC may have. If you have any questions regarding this submission, please contact Marc Panucci at [REDACTED] or Anika Heard at [REDACTED]

Sincerely,

PricewaterhouseCoopers LLP

**Detailed comments and recommendations***Proposed definition of a “compliance audit”*

The proposed definition of a “compliance audit” (ET section 0.400.09) defines such engagements, in part, as follows:

An attest engagement that is performed under the Statements on Auditing Standards when the member is requested to report on an entity’s compliance with specific requirements. For example, the member may report on compliance requirements of a contractual agreement or regulatory requirements in accordance with AU-C section 806, or report on compliance under governmental audit requirements, such as the Uniform Guidance, in accordance with AU-C section 935.

According to AU-C section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*, “the objective of the auditor is to report appropriately on an entity’s compliance with aspects of contractual agreements or regulatory requirements *in connection with the audit of financial statements*” [emphasis added]. AU-C 806.01 “addresses the auditor’s responsibility when the auditor is requested to report on an entity’s compliance with aspects of contractual agreements or regulatory requirements, insofar as they relate to relate to accounting matters, in connection with an audit of the financial statements” and that “[s]uch a report is commonly referred to as a by-product report.” Additionally, AU-C 806.07 and .12-.13 describe the required elements of the auditor’s report on compliance with aspects of contractual agreements or regulatory requirements. The auditor is only required to provide negative assurance on the compliance matter that is the subject of the report.

The auditor’s report on an entity’s compliance issued pursuant to AU-C section 806 is not the result of a standalone engagement; rather, the report is a communication provided in connection with the audit of financial statements as a by-product of the audit. Therefore, the entity is considered a “financial statement attest client” as defined in ET section 0.400.16 (0.400.18 of the proposed revisions) of the Code of Conduct and the auditor would be required to be independent of that entity pursuant to the Independence Rule and all of its applicable interpretations, including the “Client Affiliates” interpretation (ET section 1.224.010) and (when relevant) the “State and Local Government Client Affiliates” interpretation (ET section 1.224.010 and 1.224.020 of the proposed revisions). The limited independence exceptions established under the proposed revisions would not apply because the compliance report is a report prepared as part of an engagement to audit financial statements. We recommend that references to AU-C section 806 be removed from the definition of a “compliance audit.”

In contrast to AU-C section 806, AU-C section 935 provides for an auditor to express a standalone report and opinion on an entity’s compliance with the subject of the compliance audit, such as an entity’s compliance with Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (“Uniform Guidance”) applicable to federal awards. AU-C section 935 “does not apply to the financial statement audit component of [compliance audits]” (AU-C 935.02) and the auditor’s compliance report issued pursuant to AU-C 935 is not a by-product of the financial statement audit. When the auditor is engaged or required by law or regulation to provide an opinion about whether, in all material respects, an entity has “complied” with the requirements of specified laws, statutes, regulations, rules, and provisions of contracts or grant agreements or whether management’s assertion about the entity’s “compliance” with specified requirements is fairly stated, that engagement would be performed in accordance with either AU-C section 935 or AT-C section 315, *Compliance Attestation*.



Beyond the proposed definition of a “compliance audit,” paragraph 6 of the exposure draft’s explanatory memo also explains that, in addition to reporting under AU-C section 806 or 935, for example, a compliance audit engagement may also require reporting on the accuracy of a schedule, such as a schedule of expenditure of federal awards, or statement, under AU-C section 725 or 805.

Engagements to report on compliance matters under AU-C section 935 are required to include an auditor’s report on a schedule of expenditures of federal awards (SEFA). The SEFA is a supplemental schedule to the audited financial statements that determines the applicability and scope of the single audit under Uniform Guidance. The auditor’s report on an entity’s SEFA is prepared in accordance with AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*. AU-C 725.03 states that “[t]he objective of the auditor, when engaged to report on supplementary information in relation to the financial statements as a whole, is to (a) evaluate the presentation of the supplementary information in relation to the financial statements as a whole and (b) report on whether the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole.” As it relates to the SEFA, the objective of the auditor is to report on the expenditures of federal awards included in the schedule as being fairly presented in relation to the entity’s financial statements. The report under AU-C 725 does not specifically address whether the SEFA is presented in compliance with the elements required by Uniform Guidance.

Similarly, the auditor’s report on a schedule prepared in accordance with AU-C section 805, *Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, does not specifically address compliance with any set of preparation guidelines.

Paragraph 6 of the exposure draft’s explanatory memo could be interpreted to mean that a “compliance audit” extends to the accompanying schedules reported on under either AU-C section 725 or AU-C section 805. We suggest that the Committee clarify that, similar to the by-product report provided pursuant to AU-C 806, AU-C 725 and AU-C 805 audits are not considered a “compliance audit” for the purposes of applying the proposed independence exceptions.

As an overarching recommendation in light of the comments described above, we suggest that, in lieu of the first paragraph of the proposed “compliance audit” definition, the Committee either adopt the same language of the definition of a “compliance audit” in AU-C section 935.11 or incorporate the definition in AU-C section 935.11 by reference. This approach would eliminate the risk that the proposed independence exceptions are inappropriately applied to audits of financial statements performed under AU-C section 725 or AU-C section 806 or to engagements performed under AU-C section 805.

Nonattest services for compliance audit attest clients

The “Engagements, Other Than AUPs, Performed in Accordance With SSAEs” interpretation (ET section 1.297.030) establishes certain independence exceptions for engagements to issue reports in accordance with the AICPA Statements on Standards for Attestation Engagements (SSAEs). One of those exceptions relates to the member’s performance of nonattest services that do not relate to the specific subject matter of the SSAE engagement. Specifically, the interpretation states that, when providing nonattest services that would otherwise impair independence under the interpretations of the “Nonattest Services” subtopic (ET section 1.295), threats would be at an acceptable level and independence would not be impaired if (1) the nonattest services do not relate to the specific subject matter of the SSAE engagement, and (2) the “General Requirements for Performing Nonattest Services” interpretation (ET section 1.295.040) of the Independence Rule are met when providing the nonattest service.

We recommend that the PEEC consider adopting a similar approach for compliance audits. That is, the PEEC should consider amending the Code of Conduct to establish that a member’s independence would not be considered impaired due to the provision of otherwise prohibited nonattest services to a



compliance audit attest client provided that the services do not relate to the specific compliance matter that is the subject of the compliance audit and the member complies with the “General Requirements for Performing Nonattest Services” interpretation. Given that the primary objective of a compliance audit is to report on an entity’s compliance with specific requirements, nonattest services that do not relate to the specific compliance matter that is the subject of the compliance audit are unlikely, in our view, to pose threats to independence. Additionally, such an exception for nonattest services would create further consistency between the independence approach for compliance audits performed under AU-C 935 and the approach for compliance examinations performed under AT-C 315.



Responses to the supplementary questions posed by the PEEC in the exposure draft

- 1. Is the definition of “compliance audit” clear? If not, please explain how it should be clarified.**

Please refer to our detailed comments and recommendations in Appendix A regarding the proposed definition of a “compliance audit.”

- 2. Is the definition of “compliance audit attest client” clear? If not, please explain how it should be clarified.**

We believe that the proposed definition of a “compliance audit attest client” is clear.

- 3. Do you agree that there should be an exception to the independence requirements in a compliance audit for entities that are not subject to compliance audit procedures and report amounts that are trivial and clearly inconsequential? If you disagree, please explain why.**

As explained in the cover letter, we agree with the proposed exception for entities reporting trivial and clearly inconsequential amounts that are not subject to the compliance audit procedures.

- 4. Do you agree that the affiliates interpretations should not apply in a compliance audit? If you disagree, please explain why.**

As explained in the cover letter, we agree that the “Client Affiliates” interpretation and the “State and Local Government Client Affiliates” interpretation should not apply to compliance audits.

- 5. Do you agree that the revision in each of the affiliates interpretations serves as a useful reminder that these interpretations do not apply to specific attest engagements (e.g. compliance audits and engagements performed under the SSAEs)? If you disagree, please explain why.**

We agree that proposed paragraph .05 in the “Client Affiliates” interpretation and proposed paragraph .07 in the “State and Local Government Client Affiliates” interpretation serve as a necessary clarification that those interpretations do not apply to compliance audits and engagements performed in accordance with the AICPA Statements on Standards for Attestation Engagements.

- 6. Do you agree that entities that are not subject to compliance attestation procedures in an engagement performed under the SSAEs are not considered responsible parties and therefore are not subject to the “Independence Standards for Engagements Performed in Accordance with Statements on Standards for Attestation Engagements” subtopic (ET section 1.297)? If you disagree, please explain why.**

We agree that entities that are not subject to compliance attestation procedures in an engagement performed under the SSAEs are not considered responsible parties and, therefore, are not subject to the requirements of the Code of Conduct’s “Independence Standards for Engagements Performed in Accordance with Statements on Standards for Attestation Engagements” subtopic (ET section 1.297).



7. Do you agree that the effective date provides adequate time to implement the proposals? If you disagree, please explain why

We agree that the PEEC's proposed effective date provides adequate time to implement the proposed revisions.

8. What independence requirements applicable to compliance audits would you like further explained through nonauthoritative guidance?

We have no suggestions for the development of non-authoritative guidance beyond those topics already under consideration by the PEEC as described in the [agenda materials](#) for the Committee's open meeting held on May 17, 2022.