

September 1, 2022

Mr. Brian S. Lynch, Chair – Professional Ethics Executive Committee
Ms. Toni Lee-Andrews, Director - Professional Ethics Division
American Institute of Certified Public Accountants
1345 Avenue of the Americas, 27th Floor
New York, NY 10105

Mail to: Ethics-Exposure Draft@aicpa-cima.com

Re: Exposure Draft: Proposed New and Revised Definitions and Interpretations – Compliance Audits

Dear Mr. Lynch and Ms. Lee-Andrews:

Deloitte LLP (“Deloitte,” “our,” or “we”) is pleased to respond to the exposure draft issued by the Professional Ethics Executive Committee (“PEEC”) of the American Institute of Certified Public Accountants (“AICPA”) titled *Proposed New and Revised Definitions and Interpretations – Compliance Audits* (“Proposed Revisions” or “proposal”).

We appreciate the opportunity to comment on the Proposed Revisions and commend the PEEC for its efforts to provide clarity and align the independence requirements with the applicable risks in the area of compliance audits. We agree that consistency and uniformity in practice will better serve the public interest and we support the PEEC’s efforts to protect the public interest through facilitation of members’ understanding and compliance.

We encourage PEEC to consider certain suggested clarifications in the proposal and to introduce non-authoritative guidance for certain matters as described in our comments below.

Please see below our comments in response to the specific questions presented in the explanatory memorandum for PEEC’s consideration. Supplemental information related to our responses below appears in [Appendix 1](#).

Question 2a: Is the definition of “compliance audit” clear? If not, please explain how it should be clarified.

Response: The proposed definition of “compliance audit” is not clear due to:

- inconsistency with the definition of a “compliance audit” in AU-C 935 *Compliance Audits* (“AU-C 935”), potentially broadening the proposed definition to include engagements that are not compliance audits as defined by AU-C 935
- inclusion of other examples in the exposure draft background narrative that may create confusion and misinterpretation of the proposed definition

Please see our detailed response at [Appendix 1](#).

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

Response: See comments in response to Q2a above regarding revisions to the proposed “compliance audit attest client” definition. While we agree with the notion of applying a trivial and clearly inconsequential (“TCI”) test, we have several concerns and requests for clarification regarding its application as outlined in Appendix 1. These concerns may be best addressed through non-authoritative guidance for members, which should include robust examples.

Question 2c. 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.

Response: Notwithstanding our comments above and our concerns regarding the application of a TCI test, we agree there should be an exception for such entities in a compliance audit, given that threats are unlikely to be significant as it relates to such entities and their affiliates.

Question 2d. Do you agree that the affiliates interpretations should not apply in a compliance audit? If you disagree, please explain why.

Response: Notwithstanding our comments and concerns noted above regarding the application of a TCI test, we agree the affiliates interpretation should not apply in a compliance audit when amounts are not subject to compliance audit procedures and are TCI.

Question 2e. Do you agree that the revision in each of the affiliate 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.

Response: We agree the revision serves as a useful reminder regarding the application to specific attest engagements.

Question 2f. 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.

Response: We agree that entities not subject to compliance attestation procedures in such engagements are not considered responsible parties.

Question 2g. Do you agree that the effective date provides adequate time to implement the proposals? If you disagree, please explain why.

Response: We agree with the proposed effective date. In conjunction with the proposed timing, we suggest any non-authoritative guidance be finalized ahead of the effective date so that it is useful for members in implementing the changes into their policies and procedures.

Question 2h. What independence requirements applicable to compliance audits would you like further explained through nonauthoritative guidance?

Response: See responses to questions 2a-2g above.

We would be pleased to discuss our comments with you at your convenience. If you wish to do so, please contact Kathy Savage at [REDACTED] or [REDACTED] or Brandon Mercer at [REDACTED] or [REDACTED].

Sincerely,

DELOITTE + TOUCHE LLP

Appendix 1

Question 2a: Is the definition of “compliance audit” clear? If not, please explain how it should be clarified.

As explained below, the proposed definition of “compliance audit” is not clear due to:

- inconsistency with the definition of a “compliance audit” in AU-C 935 *Compliance Audits* (“AU-C 935”), potentially broadening the proposed definition to include engagements that are not compliance audits as defined by AU-C 935
- inclusion of other examples in the exposure draft background narrative that may create confusion and misinterpretation of the proposed definition.

Inconsistency with AU-C 935 definition of “compliance audit”

The primary inconsistency between the proposed definition and AU-C 935 is that the proposed definition goes beyond the population of engagements that are subject to AU-C 935. Specifically, compared to the proposed definition, the extant definition and text of AU-C 935:

- 1) does not include engagements performed under AU-C sections other than AU-C 935 in the scope of the AU-C 935 definition of compliance audits,
- 2) limits the scope of AU-C 935 to governmental audit engagements, and
- 3) explicitly states that AU-C 806 does not apply to compliance audits as defined in AU-C 935.

As explained below, we believe the proposed definition of a compliance audit should be consistent with the extant definition in AU-C 935 and should not include AU-C 806 engagements.

- First, the proposed definition of “compliance audit” includes reports on compliance under AU-C 806 *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements* (“AU-C 806”), while the extant AU-C 935 definition does not include AU-C 806 engagements. The AU-C 935 definition is shown below:

Compliance audit. *A program-specific audit or an organization wide audit of an entity's compliance with applicable compliance requirements.*

By including AU-C 806 engagements, the proposed definition goes beyond the scope of the extant AU-C 935 definition and creates two different definitions of “compliance audits” in the professional standards. This may cause the reader to interpret the proposed definition as expanding the population of compliance audits to non-governmental compliance audit engagements, which may relate to for-profit commercial entities and be subject to rules of other regulators.

- Secondly, AU-C 935 stipulates in paragraphs .01-.02 (see below) that the scope of AU-C 935 is limited to governmental audit engagements (i.e., Single Audits). In addition, the AU-C Appendix explicitly indicates all paragraphs of AU-C 806 are not applicable to compliance audits as defined in AU-C 935 (see below). The addition of a diverging definition of a compliance audit that has a broader scope than the extant professional standards will amplify complexity and cause confusion and misapplication for readers. The specific relevant excerpts from AU-C 935 are presented below.

AU-C 935 paragraphs .01-.02

.01 Governments frequently establish governmental audit requirements for entities to undergo an audit of their compliance with applicable compliance requirements. This section is applicable when an auditor is engaged, or required by law or regulation, to perform a compliance audit in accordance with all the following:

- *Generally accepted auditing standards (GAAS)*
- *The standards for financial audits under Government Auditing Standards*
- *A governmental audit requirement that requires an auditor to express an opinion on compliance (Ref: par. .A1–.A2)*

.02 This section addresses the application of GAAS to a compliance audit. Compliance audits usually are performed in conjunction with a financial statement audit. This section does not apply to the financial statement audit component of such engagements. Although certain AU-C sections are not applicable to a compliance audit, as identified in the appendix "AU-C Sections That Are Not Applicable to Compliance Audits," all AU-C sections other than this section are applicable to the audit of financial statements performed in conjunction with a compliance audit.

AU-C 935 Appendix excerpt:

<i>AU-C Section</i>	<i>Paragraphs Not Applicable to Compliance Audits</i>
<i>806, Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements</i>	<i>All</i>

- Lastly, in addition to the primary inconsistencies discussed above, there are other notable distinctions between AU-C 935 and AU-C 806 that are not addressed in the exposure draft:
 - Reports on compliance under AU-C 806 offer *negative assurance* (i.e., “nothing came to the auditor's attention that caused the auditor to believe that the entity failed to comply with specified aspects of the contractual agreements or regulatory requirements, insofar as they relate to accounting matters” (AU-C 806.07). In comparison, AU-C 935 engagements require the auditor to express an opinion on compliance (AU-C 935.01).
 - AU-C 806 engagements are in connection with audited financial statements (a byproduct report) and explicitly distinguished from compliance audits in the extant professional standards as noted above.

These additional distinctions further highlight the importance clarity and consistency between the proposal and the extant professional standards.

In summary, as noted above we believe the proposed definition of compliance audits should be consistent with the extant definition in AU-C 935 and should not include AU-C 806 engagements. However, if PEEC decides to remain inconsistent with AU-C 935, we suggest adding a statement as shown below indicating the definition should not be applied outside the Independence Rule (ET 1.200).

Suggested additions appear in ***bold italicized*** text below.

0.400. Definitions

.09 Compliance audit. 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.

This definition is solely for the purpose of applying the “Independence Rule” [1.200.001] and its interpretations and should not be used or relied upon in any other context.

A compliance audit attest engagement may include multiple compliance audit attest clients. For example, multiple compliance audit attest clients may have amounts included in a schedule of expenditures of federal awards in a compliance audit performed in accordance with the Uniform Guidance.

There is precedent for such qualifying language elsewhere in the AICPA Code, specifically in the definition of “partner equivalents” (ET 0.400.38), which contains a statement that the definition is not to be relied upon for non-independence purposes. Our understanding is this language was included to avoid confusion and misapplication of the definition in contexts outside the AICPA Code.

Inclusion of other examples in the exposure draft narrative:

Paragraph 6 of the exposure draft explanatory material cites AU-C Section 725 *Supplementary Information in Relation to the Financial Statements as a Whole* (“AU-C 725”) and AU-C Section 805 *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement* (“AU-C 805”) as examples of additional reporting as part of a compliance audit engagement, but there are no citations of these examples included in the proposed definition of compliance audit. The purpose of these examples is not clear, given there was no substantive discussion in the background and the examples were not included in the proposed definition. We agree with the omission, as AU-C 935 explicitly excludes AU-C 725 and AU-C 805 from applicability to compliance audits:

AU-C Section	Paragraphs Not Applicable to Compliance Audits
<i>725 Supplementary Information in Relation to the Financial Statements as a Whole</i>	All
<i>805 Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement</i>	All

However, if PEEC does not make any clarifying edits to the proposed definition of compliance audits and intends to include such engagements in the scope of the proposed definition, we believe PEEC should address the connection between the proposal and the examples in background for conclusions documents or non-authoritative guidance with robust examples and scenarios illustrating the application of the standard.

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

See comments in response to Q2a above regarding revisions to the proposed “compliance audit attest client” definition as well as our additional comments below. While we agree with the application of a trivial and clearly inconsequential (“TCI”) test, we have several concerns and requests for clarification regarding its application. These concerns may be best addressed through non-authoritative guidance for members, which should include robust examples.

- There is no reasonable third-party test or guidance regarding the viewpoint from which the amounts should be TCI. AU-C 935 notes that in a compliance audit, materiality is influenced by the needs of grantors (AU-C 935.A8). It is not clear from whose viewpoint amounts should be considered TCI.
- There is no point of reference for determining whether an amount is TCI. Without specific application guidance, there is a risk that the reader will assess TCI in a vacuum without considering other amounts or factors, such as the compliance audit attest client’s financial statements or the program itself.
 - Compare this to the approach to materiality in AU-C 935.A7, which states that materiality is in relation to the government program as a whole and can be specified by the governmental audit requirement. It is not clear whether the same applies to evaluation of TCI under the proposal.
 - The term TCI also appears in the *State and Local Government Client Affiliates* interpretation (ET 1.224.020) and is accompanied by a statement that TCI is in relation to the financial statements as a whole. However, the proposal remains silent on what amounts should be compared to when evaluating whether an amount is TCI. We suggest either including such guidance in the proposed revisions or providing non-authoritative guidance to clarify this important aspect of evaluating whether amounts are TCI.
- The terms immaterial and TCI may be viewed as having the same meaning in practice, and additional guidance would facilitate members’ compliance and understanding. For example, are there qualitative factors that would make an entity more than TCI, as qualitative factors would also impact the evaluation of materiality? We suggest nonauthoritative guidance to assist members’ understanding of how applying the concept of TCI is different from evaluating materiality.
- We suggest guidance regarding inadvertent breaches due to subsequent changes in TCI amounts. What should a member do if amounts are TCI at a point in time, but circumstances change after the report is issued making those amounts more than TCI? The possibility of inadvertent breaches increases in these scenarios and warrant additional guidance to avoid unintended consequences for members and clients.