



Agenda Item 2B (1)

Conforming Amendments to AU-C section 935, *Compliance Audits*

Background

AU-C section 935 is applicable when an auditor is engaged, or required by law or regulation, to perform a compliance audit in accordance with all of 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

Compliance audits usually are performed in conjunction with a financial statement audit. AU-C section 935 does not apply to the financial statement audit component of such engagements. 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.”

In addition to needing revisions due to the issuance of SAS No. 134, AU-C section 935 has not been kept current with regard for recent developments in the compliance area such as issuance of Uniform Guidance, changes in the OMB Compliance Supplement, and the new Yellow Book. Accordingly, amendments are proposed to conform with SAS No. 134 and to be consistent with current governmental requirements.

Task Force

The AU-C 935 Task Force (Task Force) members are:

- Monique Booker (Chair)
- Jeanne Dee
- Reem Samra, assisted by Kelly Chamberlin (Deloitte)
- Erica Forhan
- John Good
- Mandy Nelson
- George Strudgeon

Mr. Good, Ms. Nelson, Ms. Samra, and Mr. Strudgeon are members of the GAQC Executive Committee, and Ms. Forhan is its immediate past Chair.

Issues for Discussion With ASB

1. Appendix, “AU-C Sections That Are Not Applicable to Compliance”

Because compliance audits are performed in accordance with applicable *Government Auditing Standards* and governmental audit requirements in addition to GAAS, those who set governmental audit requirements have an interest in which AU-C sections are not applicable to compliance audits.

The changes to the appendix are as follows:

- Updating paragraph numbers for AU-C sections 700, 705 and 706
- Adding AU-C section 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*, and AU-C section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. The Task Force believes that AU-C section 701 should not apply because it is likely that relevant key audit matter would be reported as an audit finding (as defined in AU-C section 935).
- Adding paragraphs 28-30 of AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. Paragraphs 26-27 of AU-C section 315 were already included in the appendix. Because paragraphs 28-30 are performed as part of the procedures required in paragraph 26, the Task Force believes it is inconsistent to scope out paragraphs 26-27 and not paragraphs 28-30. The Task Force believes that paragraphs 16 and 17 of AU-C section 935 encompass the requirements of paragraphs 28-30 and have replaced the words “assess the risk” with the words “identify and assess the risk] of material noncompliance” to be more consistent with AU-C section 315.

AU-C section 315, paragraphs 26-30, as amended by SAS No. 134 and SAS No. 135, are shown below.

Identifying and Assessing the Risks of Material Misstatement

.26 To provide a basis for designing and performing further audit procedures, the auditor should identify and assess the risks of material misstatement at

- a. the financial statement level and (Ref: [par. .A122-.A125](#))
- b. the relevant assertion level for classes of transactions, account balances, and disclosures. (Ref: [par. .A126-.A133](#))

.27 For this purpose, the auditor should

- a. identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, by considering the classes of transactions, account balances, and disclosures (*including the quantitative and qualitative aspects of such disclosures*) in the financial statements; (Ref: [par. .A134–.A135](#))
- b. assess the identified risks and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;
- c. relate the identified risks to what can go wrong at the relevant assertion level, taking account of relevant controls that the auditor intends to test; and (Ref: [par. .A136–.A138](#))
- d. consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

Risks That Require Special Audit Consideration

- .28** As part of the risk assessment described in [paragraph .26](#), the auditor should determine whether any of the risks identified are, in the auditor’s professional judgment, a significant risk. In exercising this judgment, the auditor should exclude the effects of identified controls related to the risk.
- .29** In exercising professional judgment about which risks are significant risks, the auditor should consider at least
- a. whether the risk is a risk of fraud;
 - b. whether the risk is related to recent significant economic, accounting, or other developments and, therefore, requires specific attention;
 - c. the complexity of transactions;
 - d. whether the risk involves significant transactions with related parties;
 - e. the degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
 - f. whether the risk involves significant unusual transactions. (Ref: [par. .A139–.A143](#))
- .30** If the auditor has determined that a significant risk exists, the auditor should obtain an understanding of the entity’s controls, including control activities, relevant to that risk and, based on that understanding, evaluate whether such controls have been suitably designed and implemented to mitigate such risks. (Ref: [par. .A144–.A146](#))

Does the ASB agree with the proposed revisions to the appendix?

2. Combined versus Separate Reports

Paragraphs 30-37 of AU-C section 935 address reporting. Requirements for reporting on compliance only are presented first, in paragraph 30. Subsequent paragraphs address how to revise the report elements required previously in order to prepare a combined report or a separate report on internal control over compliance.

While issuing separate reports is not prohibited, the Task Force is not aware of separate reports being issued in practice. Accordingly, the Task Force is recommending that AU-C section 935 address combined reports as the default presentation. The Task Force has not included requirements on how to revise the combined report if separate reports are to be issued and believes whether to do so should be included as a specific question to respondents in the Exposure Draft.

Action Requested of the ASB

Does the ASB agree with the decision to include requirements for a combined report only?

3. “Significant Audit Findings”

SAS No. 134, section 700, paragraph 37, requires that the “Auditor’s Responsibilities for the Audit of the Financial Statements” section of the auditor’s report should also state that the auditor is required to communicate with those charged with governance regarding, among other matters, significant audit findings. The requirement to communicate significant audit findings is located in AU-C section 260, *The Auditor’s Communication With Those Charged With Governance*. The Task Force is concerned that referring to “significant audit findings” in the auditor’s report on compliance would create confusion, because “audit findings” is a defined term in AU-C 935: “The matters that are required to be reported by the auditor in accordance with the governmental audit requirement.” Because the report language includes the term “among other matters”, the Task Force recommends that the auditor’s report on compliance omit the reference to “significant audit findings.”

Action Requested of the ASB

Does the ASB agree that using “significant audit findings” in the report on compliance would create confusion and with the omission of that term?

4. Change to Federal guidelines

Federal guidelines on compliance audits have been issued that limit the number of compliance requirements that can be audited to six (or seven in the case of Research & Development). The Government Audit Quality Center is working on addressing, for audits performed under the 2019

OMB Compliance Supplement, whether, and if so how, to communicate in the auditor's report that the compliance requirements that are audited are a subset of compliance requirements that may have a "direct and material effect". Any revisions to AU-C section 935 that are necessary as a result of that resolution will be brought to the ASB at its October meeting.

Materials Presented:

Item 2B (2)	AU-C section 935, marked for proposed revisions
Item 2B (3)	Comparison of reporting requirements