



## Agenda Item 3B (1)

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

#### Objective

To vote to ballot for exposure proposed amendments to AU-C section 935, *Compliance Audits*, to conform to 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.

#### Summary of July ASB Meeting Discussion and Disposition of ASB Comments

Regarding the issues brought to the ASB at its July meeting:

- The ASB agreed with the revisions to the appendix.
  - Adding paragraphs 28-30 of AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, to the appendix does not have any implications because the requirements of AU-C 935 have the same effect.
  - The exclusion of AU-C section 701, *Communication Key Audit Matters in the Independent Auditor's Report*, is appropriate because KAMs apply in an audit of a full set of financial statements, which a compliance audit is not.
- The ASB agreed with the Task Force recommendation of not including “significant audit findings”, as the phrase “among other matters” encompasses it. The ASB asked the Task

Force to consider adding a footnote referring to AU-C section 260, *The Auditor's Communication With Those Charged With Governance*. **Footnote 9 of paragraph 37, which has been retained from the extant, refers to AU-C section 260.**

- The ASB were informed about the changes to Federal guidelines and that, subsequent to the agenda materials being posted, it was decided to issue a TQA for 2019.
- The ASB agreed with presenting the combined report as the default but instructed the Task Force to add material addressing when the auditor chooses to prepare separate reports, and to describe this change in the ED wrap. **See paragraph 30A.**

Other significant issues and considerations directed by the ASB in July are as follows:

1. The definition of material noncompliance and the description included in the report.  
SAS No. 134 requires that the auditor's report include the statement that "misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements." Accordingly, the amendments to AU-C 935 require that the report include a statement defining material noncompliance. The draft discussed in July stated that "noncompliance is considered material to the entity's compliance with the applicable compliance requirements, if, individually or in the aggregate, it could reasonably be expected to influence the decisions of the users of the report on compliance". The ASB questioned if "the decisions of the users of the report on compliance" was the appropriate measure.

Because the ASB will be finalizing the description of materiality at its October meeting (see agenda item 2, *Description of Materiality*), the definition of material noncompliance and the description included in the report were revised to conform to the definition proposed in Agenda item 2.

The revised definition of material noncompliance in paragraph 11 of AU-C 935 is

**Material noncompliance.** In the absence of a definition of material noncompliance in the governmental audit requirement, noncompliance with the applicable compliance requirements, whether quantitative or qualitative, is considered to be material to the entity's compliance if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user about the government program in its entirety based on the report on compliance

2. The illustrative report on internal control over compliance

As directed by the ASB, the paragraph starting "Our consideration ..." was moved to follow the paragraph starting "A deficiency in...". In addition, the Task Force added a requirement in paragraph 30i(ii) to include a statement that

Our audit was not designed for the purpose of expressing an opinion on the effectiveness of internal control over compliance, and we do not express an opinion on the effectiveness of Example Entity's internal control over compliance.

Although the same sentence is included in the last bullet under the “Auditor’s Responsibilities for the Audit of Compliance”, the Task Force believes that there are users who will look at the “Report on Internal Control Over Compliance” section of the combined report before reading the rest of the combined report, and if so, that sentence is necessary in that section.

3. Consideration of additional wording to paragraph 16 regarding risk assessment.

The ASB noted that paragraph 16 of AU-C section 935 is general enough to cover the concepts in paragraphs 30 of AU-C section 315 but directed the Task Force to consider whether additional specificity from paragraph 30 of AU-C section 315 should be added to paragraph 16. The Task Force considered both AU-C 315.30 and AU-C 935.16 and concluded that additional specificity is not necessary. There is no evidence of a problem in practice relating to this paragraph, the wording to add is not obvious, and it appears beyond the scope of the project to conform to SAS No. 134.

4. Laws and statutes

Paragraphs 30(f) and A11 were revised for the consistent use of the phrase “laws, statutes, regulations, rules and provisions” throughout the AU-C section. The phrase is used in the Uniform Guidance. As directed by the ASB, the Task Force considered whether to add the word “statutes” to the phrase “laws and regulations”, but because the reference to “statutes” is from the Uniform Guidance, and because the phrase “laws and regulations” is used extensively throughout GAAS, the Task Force made no change.

Editorial changes from the draft brought to the ASB in July are as follows:

- Added the same application material about the report date that was added to AU-C section 940, as well as the footnote on the statement about auditor independence in the auditor’s report. See new paragraph A32A and footnote to paragraph 30e(iii).
- Revised paragraph A35 to refer just to the auditor’s report and not specifically to the auditor’s report on compliance.
- Added the phrase “whether due to fraud or error” in the “Auditor’s Responsibilities” section to be consistent with the requirement in paragraph 30.
- Revised paragraph 30 to refer to “the auditor’s combined report on compliance and internal control over compliance” and other edits to refer to the report on compliance and the report on internal control over compliance.
- Paragraph A7, revised, using wording from CFR sec. 200.516(a)(2), to say “the Uniform Guidance states that the auditor’s determination of whether noncompliance is material for

the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program identified in the OMB *Compliance Supplement (Compliance Supplement)*“”

- Inserted the word “material” in the illustrative report, in the “Auditor’s Responsibilities” section, before “noncompliance”.
- Paragraph A36, changed “noncompliance findings” to “[insert type of findings such as noncompliance or internal control over compliance]”

**Materials Presented:**

- Item 3B (2) AU-C section 935, marked for proposed revisions
- Item 3B (3) Proposed amendments to AU-C section 935
- Item 3B (4) Clean Illustrative Combined Report

Ms. Booker will use agenda item 3B (2) for the ASB discussion.