



Agenda Item 1B (2)

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

AU-C Section 935, *Compliance Audits*

[No proposed amendments to paragraphs .01–.03.]

- .04** AU-C sections 200–~~800~~**900** address audits of financial statements, as well as other kinds of engagements. Generally, these AU-C sections can be adapted to the objectives of a compliance audit. However, those AU-C sections, or portions thereof, identified in the appendix cannot be adapted to a compliance audit because they address the matters that are not applicable to a compliance audit.

[No proposed amendments to paragraphs .05–.07.]

- .08** A compliance audit is based on the premise that management is responsible for the entity's compliance with compliance requirements. Management's responsibility for the entity's compliance with compliance requirements includes the following:
- a. Identifying the entity's government programs and understanding and complying with the compliance requirements
 - b. ~~Establishing~~ **Designing, implementing,** and maintaining effective controls that provide reasonable assurance that the entity administers government programs in compliance with the compliance requirements
 - c. Evaluating and monitoring the entity's compliance with the compliance requirements
 - d. Taking corrective action when instances of noncompliance are identified, including corrective action on audit findings of the compliance audit

[No proposed amendments to paragraph .09.]

- .10** The auditor's objectives in a compliance audit are to
- a. obtain sufficient appropriate audit evidence to form an opinion and report at the level specified in the governmental audit requirement ~~on~~ **about** whether the entity

complied in all material respects with the applicable compliance requirements;
and

- b. identify audit and reporting requirements specified in the governmental audit requirement that are supplementary to GAAS and *Government Auditing Standards*, if any, and perform procedures to address those requirements.

Definitions

- .11 For purposes of adapting GAAS to a compliance audit, the following terms have the meanings attributed as follows:

Applicable compliance requirements. Compliance requirements that are subject to the compliance audit.

Audit findings. The matters that are required to be reported by the auditor in accordance with the governmental audit requirement.

Audit risk of noncompliance. The risk that the auditor expresses an inappropriate audit opinion on the entity's compliance when material noncompliance exists. Audit risk of noncompliance is a function of the risks of material noncompliance and detection risk of noncompliance.

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

Compliance requirements. Laws, *statutes*, regulations, rules, and provisions of contracts or grant agreements applicable to ~~a government programs~~ **program** with which the entity is required to comply.

Deficiency in internal control over compliance. A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance on a timely basis. A deficiency in *design* exists when (a) a control necessary to meet the control objective is missing, or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in *operation* exists when a properly designed control does not operate as designed or the person performing the control does not possess the necessary authority or competence to perform the control effectively.

Detection risk of noncompliance. The risk that the procedures performed by the auditor to reduce audit risk of noncompliance to an acceptably low level will not detect noncompliance that exists and that could be material, either individually or when aggregated with other instances of noncompliance.

Government Auditing Standards. Standards and guidance issued by the Comptroller General of the United States, U.S. Government Accountability Office for financial audits, *reviews of financial statements*, attestation engagements, and performance audits. *Government Auditing Standards* also is known as generally accepted government auditing standards (GAGAS) or the Yellow Book.

Government program. The means by which governmental entities achieve their objectives. For example, one of the objectives of the U.S. Department of Agriculture is to provide nutrition to individuals in need. Examples of government programs designed to achieve that objective are the Supplemental Nutrition Assistance Program and the National School Lunch Program. Government programs that are relevant to this section are those in which a grantor or pass-through entity provides an award to another entity, usually in the form of a grant, contract, or other agreement. Not all government programs provide cash assistance; sometimes noncash assistance is provided (for example, a loan guarantee, commodities, or property).

Governmental audit requirement. A government requirement established by law, *statute*, regulation, rule, or provision of contracts or grant agreements requiring that an entity undergo an audit of its compliance with applicable compliance requirements related to one or more government programs that the entity administers. (Ref: par. .A4)

Grantor. A government agency from which funding for the government program originates.

Known questioned costs. Questioned costs specifically identified by the auditor. Known questioned costs are a subset of likely questioned costs.

Likely questioned costs. The auditor's best estimate of total questioned costs, not just the known questioned costs. Likely questioned costs are developed by extrapolating from audit evidence obtained, for example, by projecting known questioned costs identified in an audit sample to the entire population from which the sample was drawn.

Material noncompliance. In the absence of a definition of material noncompliance in the governmental audit requirement, ~~a failure to follow compliance requirements or a violation of prohibitions included in~~ ***noncompliance with the applicable compliance requirements that results in noncompliance is considered quantitatively or qualitatively material if there is a substantial likelihood that is quantitatively or qualitatively material, either individually or when aggregated with other noncompliance in the aggregate, it would influence the judgment made to the affected government program about compliance with the requirements of the government program as a whole by a reasonable user of the report on compliance.***

Material weakness in internal control over compliance. A deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis. In this section, a reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable as defined as follows:

Reasonably possible. The chance of the future event or events occurring is more than remote but less than likely.

Probable. The future event or events are likely to occur.

Organization-wide audit. An audit of an entity's financial statements and an audit of its compliance with the applicable compliance requirements as they relate to one or more government programs that the entity administers.

Pass-through entity. An entity that receives an award from a grantor or other entity and distributes all or part of it to another entity to administer a government program.

Program-specific audit. An audit of an entity's compliance with applicable compliance requirements as they relate to one government program that the entity administers. The compliance audit portion of a program-specific audit is performed in conjunction with either an audit of the entity's or the program's financial statements.

Questioned costs. Costs that are questioned by the auditor because (1) of a violation or possible violation of the applicable compliance requirements, (2) the costs are not supported by adequate documentation, or (3) the incurred costs appear unreasonable and do not reflect the actions that a prudent person would take in the circumstances.

Risk of material noncompliance. The risk that material noncompliance exists prior to the audit. This consists of two components, described as follows:

Inherent risk of noncompliance. The susceptibility of a compliance requirement to noncompliance that could be material, either individually or when aggregated with other instances of noncompliance, before consideration of any related controls over compliance.

Control risk of noncompliance. The risk that noncompliance with a compliance requirement that could occur and that could be material, either individually or when aggregated with other instances of noncompliance, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control over compliance.

Significant deficiency in internal control over compliance. A deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Requirements

[No proposed amendments to paragraphs .12–.15.]

- .16** In performing risk assessment procedures, the auditor should inquire of management about whether there are findings and recommendations in reports or other written communications resulting from previous audits, attestation engagements, and internal or external monitoring that directly relate to the objectives of the compliance audit. The auditor should gain an understanding of management’s response to findings and recommendations that could have a material effect on the entity’s compliance with the applicable compliance requirements (for example, taking corrective action). The auditor should use this information to **identify and** assess ~~risk~~ **risks of material noncompliance** and determine the nature, timing, and extent of the audit procedures for the compliance audit, including determining the extent to which testing the implementation of any corrective actions is applicable to the audit objectives.

Identifying and Assessing the Risks of Material Noncompliance (Ref: par. .A16–.A18)

- .17** The auditor should **identify and** assess the risks of material noncompliance whether due to fraud or error for each applicable compliance requirement and should consider whether any of those risks are pervasive to the entity’s compliance because they may affect the entity’s compliance with many compliance requirements.^{fn2}

^{fn2} ~~Paragraphs .28–.32 of section 315.~~

[Footnote 2 is deleted. Subsequent footnotes are renumbered.]

[No proposed amendments to paragraphs .18–.22.]

Written Representations

- .23** The auditor should request from management written representations that are tailored to the entity and the governmental audit requirement (Ref: par. .A28)
- a. acknowledging management’s responsibility for understanding and complying with the compliance requirements;
 - b. acknowledging management’s responsibility for ~~establishing~~ **the design, implementation and maintenance of** controls that provide reasonable assurance that the entity administers government programs in accordance with the compliance requirements;

Commented [AG1]: To be consistent with AU-C 700

[No further amendment to paragraph .23. No proposed amendments to paragraphs .24–.29.]

Reporting

Combined Report on Compliance ~~Only~~ and Internal Control Over Compliance

- .30** The auditor’s *combined* report on compliance *and internal control over compliance* should be in writing and include the following elements:
- a. **Title.** *The auditor’s report should have a title that includes clearly indicates that it is the word report of an independent auditor.*
 - b. **Addressee.** *The auditor’s report should be addressed, as an addressee appropriate, ~~for~~ based on the circumstances of the engagement.*
 - c. **Report on Compliance.** *The report on compliance should be presented before the report on internal control over compliance and include the heading “Report on Compliance.”*
 - e. ~~An introductory paragraph that includes the following:~~
 - d. **Opinion.** *The first section of the auditor’s report on compliance should include the auditor’s opinion and section with a heading that includes the word “Opinion” and indicates the reporting level pursuant to the governmental audit requirement. The “Opinion” section of the auditor’s report should also do the following (Ref: par. .A34):*
 - i. *State that the entity’s compliance with the applicable compliance requirements has been audited*
 - ii. ~~Identification of~~ *Identify the applicable compliance requirements or include a reference to where they can be found*
 - iii. ~~Identification of~~ *Identify the one or more government programs covered by the compliance audit or reference to a separate schedule containing that information*
 - iii-iv. ~~Identification of~~ *Specify the period covered by the report*
 - v. *When expressing an unmodified opinion, state that, in the auditor’s opinion, the entity complied, in all material respects, with the applicable compliance requirements that are applicable to indicate the reporting level pursuant to the governmental audit requirement for the [specify the period covered by the report].*
 - e. **Basis for Opinion.** *The auditor’s report on compliance should include a section, directly following the “Opinion” section, with the heading “Basis for Opinion,” that does the following:*

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Commented [AG3]: To align with wording used in illustrative report

- i. *States that the audit of compliance was conducted in accordance with auditing standards generally accepted in the United States of America (GAAS), the standards applicable to financial audits contained in Government Auditing Standards (Government Auditing Standards) issued by the Comptroller General of the United States, and the governmental audit requirement*
- ii. *Refers to the section of the auditor's report that describes the auditor's responsibilities under GAAS, Government Auditing Standards, and the governmental audit requirement*
- iii. *Includes a statement that the auditor is required to be independent of the entity and to meet the auditor's other ethical responsibilities in accordance with the relevant ethical requirements relating to the audit*^{fn5}
- iv. ~~A statement that~~ *States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion*
- v. ~~A statement~~ *States that the compliance audit does not provide a legal determination of the entity's compliance with the applicable compliance requirements*

^{fn 4} See paragraphs .A38-.A39 of section 700, Forming an Opinion and Reporting on Financial Statements.

~~d.f. A-Management's Responsibilities.~~ *The auditor's report on compliance should include a section with the heading "Management's Responsibilities" that includes a statement that "Responsibilities of Management for Compliance." This section of the auditor's report should describe management's responsibility for compliance with the applicable compliance requirements ~~is the responsibility of the entity's management.~~ and for the design, implement, and maintain the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to the entity's government programs. If the document containing the auditor's report contains a separate statement by management about its responsibility for the applicable compliance requirements, the auditor's report should not include a reference to such statement by management.*

eg. Auditor's Responsibilities. The auditor's report on compliance should include a ~~A~~ section with the heading "Auditor's Responsibility ~~Responsibilities for the Audit of Compliance.~~" This section of the auditor's report should do that includes the following statements:

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Commented [AG6]: To align with AU-C 700

Commented [AG7]: To align with illustrative report.

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- i. ~~A statement~~ *State that the auditor's responsibility is objectives of the auditor are to*
- (1) *obtain reasonable assurance about whether material noncompliance with the applicable compliance requirements occurred, whether due to fraud or error*
 - (2) *express an opinion on the entity's compliance with the applicable compliance requirements based on the compliance audit*
- ii. ~~A statement~~ *State that the compliance reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit was conducted in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in GAAS, Government Auditing Standards, and the governmental audit requirement will always detect material noncompliance when it exists*
- iii. *State that the risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control*
- iv. *State that noncompliance with the applicable compliance requirements is considered material if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made about compliance with the requirements of the government program as a whole by a reasonable user of the report on compliance*
- v. *Describe an audit by stating that, in performing an audit in accordance with GAAS, Government Auditing Standards, and the [insert the name of the governmental audit requirement or program-specific audit guide] the auditor's responsibilities are to*
- (1) *exercise professional judgment and maintain professional skepticism throughout the audit.*
 - (2) *identify and assess the risks of material noncompliance whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include ~~A statement that the compliance audit included~~ examining, on a test basis, evidence ~~about~~ regarding the entity's compliance with those applicable compliance requirements and performing such other procedures as the auditor considered necessary in the circumstances.*

(3) *obtain an understanding of the entity's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances and to test and report on internal control over compliance in accordance with [the governmental audit requirement], but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over compliance. Accordingly, no such opinion is expressed.*

Commented [AG9]: See Issue 3

~~iv. A statement that the auditor believes the compliance audit provides a reasonable basis for the auditor's opinion~~

~~v. A statement that the compliance audit does not provide a legal determination of the entity's compliance~~

vi. *State that the auditor is required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that the auditor identified during the audit*

~~f. If noncompliance results in a modified opinion, a section with an appropriate heading, indicating the basis for the modified opinion that includes a description of such noncompliance, or a reference to a description of such noncompliance in an accompanying schedule.^{fn-5} (Ref: par A34)~~

~~^{fn-5} Paragraph .17 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.~~

h. If noncompliance that *does not result in a modified opinion but* is required to be reported by the governmental audit requirement is identified ~~(that is, noncompliance that does not result in a modified opinion)~~, *the auditor's report should include* an other-matter paragraph, *in a separate section with the heading "Other Matter" or another appropriate heading*, that ^{fn-64} includes a description of such noncompliance or a reference to a description of such noncompliance in an accompanying schedule. (Ref: par. .A34)

^{fn-5} Paragraph .08 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

i. **Report on Internal Control Over Compliance.** *The auditor's combined report on compliance and internal control over compliance should include a section with the heading "Report on Internal Control Over Compliance" that does the following:*

- i. ***Includes the definitions of deficiency in internal control over compliance, material weakness in internal control over compliance, and significant deficiency in internal control over compliance.***
- ii. ***States that the auditor's consideration of the entity's internal control over compliance was for the limited purpose described in the Auditor's Responsibilities for the Audit of Compliance section above and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies in internal control over compliance and therefore material weaknesses or significant deficiencies in internal control over compliance may exist that were not identified.***
- iii.i. ~~Describes any identified material weaknesses and significant~~
~~Describes any identified material weaknesses and significant~~
~~Describes any identified material weaknesses and significant~~
- ~~iii.~~ ***Describes any identified material weaknesses and significant deficiencies in internal control over compliance or a reference to an accompanying schedule containing such a description.***
- v.iv. ***If no material weaknesses in internal control over compliance were identified, includes a statement to that effect.***
- v. ***States that the audit was not designed for the purpose of expressing an opinion on the effectiveness of the entity's internal control over compliance. Accordingly, no such opinion is expressed.***

Commented [AG10]: To be consistent with report language in AU-C 265.A39 and illustrative report in par. A44 below.

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- ij. If the criteria used to evaluate compliance are
 - i. established or determined by contractual agreement or regulatory provisions that are developed solely for the parties to the agreement or regulatory agency responsible for the provisions or
 - ii. available only to the specified parties

an alert describing the purpose of the auditor's report ***on compliance and internal control over compliance*** and that the report is not suitable for any other purpose, as required by section 905, *Alert That Restricts the Use of the Auditor's Written Communication*.^{fn 76}

^{fn 6} See paragraphs .06a–b, .11, and .A11 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*.

- jk. The manual or printed signature of the auditor's firm.
- kl. The city and state where the ~~auditor practices~~ ***auditor's report is issued.***

lm. The date of the auditor's report. *The auditor's report should be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on compliance, including evidence that management has asserted that it has identified the entity's government programs and has taken responsibility for understanding and complying with the compliance requirements.* (Ref: par. .A35)

A combined report on compliance and internal control over compliance is presented in the exhibit "Illustrative Combined Report on Compliance With Applicable Requirements and Internal Control Over Compliance — (Unmodified Opinion on Compliance; No Material Weaknesses or Significant Deficiencies in Internal Control Over Compliance Identified)."

Commented [AG12]: Deleted to be consistent with management's representation required by par. 23a.

Commented [AG13]: Moved to more logical placement.

~~Combined Report~~ **Separate Reports on Compliance and Internal Control Over Compliance**

.31 *If the auditor issues separate reports on compliance and internal control over compliance, the separate report on compliance would omit the elements related to internal control over compliance (paragraph .30i). The separate report on internal control over compliance would omit the elements related to compliance (paragraph .30c–h) and would include the following additional statements:*

- a. A statement that the auditor audited the entity's compliance with applicable compliance requirements pertaining to [identify the government program or programs and the period audited] and a reference to the auditor's report on compliance*
- b. A statement that the compliance audit was conducted in accordance with auditing standards generally accepted in the United States of America (GAAS), the standards applicable to financial audits contained in Government Auditing Standards (Government Auditing Standards) issued by the Comptroller General of the United States, and the governmental audit requirement*
- c. A statement that management is responsible for designing, implementing, and maintaining effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to government programs*
- d. A statement that in planning and performing the compliance audit, the auditor considered the entity's internal control over compliance with the applicable compliance requirements to determine the auditing procedures for the purpose of expressing an opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance*
- e. A statement that the auditor is not expressing an opinion on internal control over compliance*

~~—— If the governmental audit requirement requires the auditor to report on internal control over compliance and the auditor combines the auditor's report on compliance with a report on internal control over compliance, the following should be added to the report elements listed in paragraph .30 in a section with the heading "Internal Control Over Compliance" that appears before the section required by paragraph 30i, if any:~~

- ~~a. A statement that management is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, rules, and provisions of contracts or grant agreements applicable to government programs.~~
- ~~b. A statement that in planning and performing the compliance audit, the auditor considered the entity's internal control over compliance with the applicable compliance requirements to determine the auditing procedures for the purpose of expressing an opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance.~~
- ~~c. A statement that the auditor is not expressing an opinion on internal control over compliance.~~
- ~~d. A statement that the auditor's consideration of the entity's internal control over compliance was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses in internal control over compliance.~~
- ~~e. The definition of *deficiency in internal control over compliance* and *material weakness in internal control over compliance*.~~
- ~~f. A description of any identified material weaknesses in internal control over compliance or a reference to an accompanying schedule containing such a description.~~
- ~~g. If significant deficiencies in internal control over compliance were identified, the definition of *significant deficiency in internal control over compliance* and a description of the deficiencies or a reference to an accompanying schedule containing such a description.~~
- ~~h. If no material weaknesses in internal control over compliance were identified, a statement to that effect.~~
- ~~i. The alert described in paragraph .30i. The alert should be included in all combined reports on the entity's compliance and internal control over compliance.~~

~~A combined report on compliance and internal control over compliance is presented in the exhibit "Illustrative Combined Report on Compliance With Applicable Requirements and Internal Control Over Compliance" (Unmodified Opinion on Compliance; No~~

~~Material Weaknesses or Significant Deficiencies in Internal Control Over Compliance Identified);”~~

Separate Report on Internal Control Over Compliance

~~.32~~ If the governmental audit requirement requires the auditor to report on internal control over compliance and the auditor chooses to issue a separate report on internal control over compliance, the auditor should include in that separate report the elements in paragraph ~~.31a-i~~ and the following additional elements:

- ~~a. a.~~ A title that includes the word independent
- ~~b.~~ A statement that the auditor audited the entity’s compliance with applicable compliance requirements pertaining to ~~[identify the government program(s) and the period audited]~~ and a reference to the auditor’s report on compliance
- ~~c.~~ A statement that the compliance audit was conducted in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, and the governmental audit requirement
- ~~d.~~ The manual or printed signature of the auditor’s firm
- ~~e.~~ The date of the auditor’s report

[Extant paragraph .33 is renumbered as paragraph .32. The content is unchanged.]

Other Reporting Considerations

~~.3433~~ The auditor should modify the auditor’s opinion on compliance in accordance with section 705, *Modifications to the Opinion in the Independent Auditor’s Report*, if any of the following conditions exist:

- ~~a.~~ The ~~compliance~~ **auditor concludes that, based on the audit identifies evidence obtained, material noncompliance with the applicable compliance requirements exists.**
- ~~b.~~ **The auditor is unable to obtain sufficient appropriate audit evidence to conclude whether material noncompliance with the applicable compliance requirements that the auditor believes has a material effect on the entity’s compliance exists.**
- ~~b.~~ A restriction on the scope of the compliance audit.

~~.34~~ **When noncompliance results in a modified opinion, the “Basis for Opinion” section, with an appropriately modified heading, should include a description of such noncompliance, or a reference to a description of such noncompliance in an**

accompanying schedule, and a statement that compliance with such requirements is necessary, in the auditor's opinion, for the entity to comply with the applicable compliance requirements.^{fn 7}

^{fn 7} Paragraph .21 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

[No proposed amendment to paragraph .35.]

~~.36~~ In the absence of a governmental audit requirement to report on internal control over compliance, the auditor should, nevertheless, communicate in writing to management and those charged with governance identified significant deficiencies and material weaknesses in internal control over compliance.^{fn 8} (Ref: par. .A35–.A36)

~~.37~~**.3736** The auditor also should communicate to those charged with governance of the auditor's responsibilities under GAAS, *Government Auditing Standards*, and the governmental audit requirement, an overview of the planned scope and timing of the compliance audit, and *any significant deficiencies and material weaknesses in internal control over compliance that the auditor identified during the audit* significant findings from the compliance audit^{fn 8, fn 9} (Ref: par. .A357–.A368)

^{fn 8} See section 265, *Communicating Internal Control Related Matters Identified in an Audit*.

^{fn 9} See section 260, *The Auditor's Communication With Those Charged With Governance*.

[No proposed amendments to paragraphs .38–.43, renumbered as paragraphs .37–.42.]

Application and Other Explanatory Material

Introduction and Applicability

.A1 An example of an engagement to which this section is applicable is an audit performed in accordance with the provisions of ~~Office Title 2 U.S. Code of Management~~ **Federal Regulations (CFR) Part 200, Uniform Administrative Requirements, Cost Principles, and Budget** (OMB) Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations* **Audit Requirements for Federal Awards (the Uniform Guidance)**. This section is applicable because ~~OMB Circular A-133~~ **the Uniform Guidance** is a governmental audit requirement that requires the auditor to perform a compliance audit in accordance with both GAAS and *Government Auditing Standards* and to express an opinion on compliance. Another example is a department specific requirement such as the U.S. Department of Housing and Urban Development *Audit Requirements Related to Entities Such As Public Housing Agencies, Nonprofit and For-Profit Housing Projects, and Certain Lenders*. An example of an engagement to which this section is not applicable is an engagement performed to satisfy a law or regulation requiring the entity to have an auditor determine whether the entity has spent transportation excise tax monies in accordance with the specific purposes outlined in the

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law or regulation, but not requiring that the audit be performed in accordance with both GAAS and *Government Auditing Standards*. Such an engagement could be performed under AT-C section 315; AT-C section 205; or AT-C section 215, *Agreed-Upon Procedures Engagements*, depending on the requirements of the government.

Law or regulation will not always indicate which standards to follow. In such cases, professional judgment will be needed to determine, based on the circumstances, the appropriate standards to follow. (Ref: par. .01)

- .A2 An example of a governmental audit requirement that calls for an examination of an entity's compliance with specified requirements in accordance with AT-C section 315 is the ***compliance attestation engagement of third-party servicers included in the U.S. Department of Education's audit guide ~~Guide for Audits of Federal Student Financial Assistance Programs at Participating Institutions~~ Proprietary Schools and Institution For Compliance Attestation Engagements of Third-Party Servicers Administering Title IV Programs***. (Ref: par. .01 and .03)

[No proposed amendments to paragraphs .A3–.A6.]

- .A7 Generally, for all of the purposes identified in paragraph .A6, the auditor's consideration of materiality is in relation to the government program ~~taken~~ as a whole. However, the governmental audit requirement may specify a different level of materiality for one or more of these purposes. For example, ~~for purposes of reporting findings of noncompliance, OMB Circular A-133~~ ***the Uniform Guidance requires states that the auditor's determination of whether noncompliance that is material for the purpose of reporting an audit finding is in relation to a type one of the 14 types of compliance requirements identified in the OMB Compliance Supplement (Compliance Supplement)***. (See paragraph .A10 for further information about the *Compliance Supplement*.)

[No proposed amendments to paragraph .A8.]

- .A9 Some governmental audit requirements specifically identify the applicable compliance requirements. Other governmental audit requirements provide a framework for the auditor to determine the applicable compliance requirements. For example, the *Compliance Supplement* provides such a framework for ~~OMB Circular A-133~~ ***compliance audits under the Uniform Guidance***.
- .A10 The following are some of the sources an auditor may consult when identifying and obtaining an understanding of the applicable compliance requirements:
- a. The *Compliance Supplement*, which is issued by OMB, and used in ~~OMB Circular A-133~~ ***compliance audits under the Uniform Guidance***, contains the compliance requirements that typically are applicable to federal government programs, as well as suggested audit procedures when compliance requirements are applicable and have a direct and material effect on the entity's compliance.

Part 7 of the *Compliance Supplement* provides guidance for identifying compliance requirements for programs not included therein.

- b. The applicable program-specific audit guide issued by the grantor agency, which contains the compliance requirements pertaining to the government program and suggested audit procedures to test for compliance with the applicable compliance requirements.

.A11 The following are procedures the auditor may perform to identify and obtain an understanding of the applicable compliance requirements if the *Compliance Supplement* or a program-specific audit guide is not applicable:

- a. Reading laws, *statutes*, regulations, rules, and provisions of contracts or grant agreements that pertain to the government program
- b. Making inquiries of management and other knowledgeable entity personnel (for example, the chief financial officer, internal auditors, legal counsel, compliance officers, or grant or contract administrators)
- c. Making inquiries of appropriate individuals outside the entity, such as
 - i. the office of the federal, state, or local program official or auditor, or other appropriate audit oversight organizations or regulators, about the laws and regulations applicable to entities within their jurisdiction, including statutes and uniform reporting requirements
 - ii. a third-party specialist, such as an attorney
- d. Reading the minutes of meetings of the governing board of the entity being audited
- e. Reading audit documentation about the applicable compliance requirements prepared during prior years' audits or other engagements
- f. Discussing the applicable compliance requirements with auditors who performed prior years' audits or other engagements

The procedures listed in this paragraph also may assist the auditor in obtaining a further understanding of the applicable compliance requirements even when the *Compliance Supplement* or program-specific audit guide is applicable.

[No proposed amendments to paragraphs .A12–.A15.]

Identifying and Assessing the Risks of Material Noncompliance (Ref: par. .17)

.A16 Factors the auditor may consider in *identifying and* assessing the risks of material noncompliance are as follows:

- The complexity of the applicable compliance requirements
- The susceptibility of the applicable compliance requirements to noncompliance
- The length of time the entity has been subject to the applicable compliance requirements
- The auditor's observations about how the entity has complied with the applicable compliance requirements in prior years
- The potential effect on the entity of noncompliance with the applicable compliance requirements
- The degree of judgment involved in adhering to the compliance requirements
- The auditor's assessment of the risks of material misstatement in the financial statement audit

.A17 In *identifying and* assessing the risks of material noncompliance, the auditor may evaluate inherent risk of noncompliance and control risk of noncompliance individually or in combination.

[No proposed amendments to paragraphs .A18–.A20.]

.A21 An auditor may decide to use audit sampling to obtain sufficient appropriate audit evidence in a compliance audit. Section 530, *Audit Sampling*, discusses the factors to be considered in planning, designing, and evaluating audit samples, including sampling for tests of controls. In addition, the AICPA Audit Guide Government Auditing Standards and ~~Circular A-133~~ **Single Audits** contains guidance on sampling in the context of a compliance audit. (Ref: par. .19)

[No proposed amendments to paragraphs .A22–.A23.]

.A24 Section 330 provides guidance related to designing and performing further audit procedures in response to the assessed risks of material noncompliance.^{fn15} **However, the paragraphs of s**Section 330 ~~that, which also addresses~~ **address** the use of audit evidence about the operating effectiveness of controls obtained in prior audits; are not applicable to a compliance audit.^{fn 16} (Ref: par. .20)

[Footnotes 15 and 16 are not shown for purposes of this proposed SAS.]

- ~~.A25~~ Some governmental audit requirements, for example, in ~~OMB Circular A-133~~ *the Uniform Guidance*, require tests of the operating effectiveness of controls identified as likely to be effective, even if the auditor believes that such testing would be inefficient. (Ref: par. .20)

Supplementary Audit Requirements

- ~~.A26~~ Examples of supplementary audit requirements are the requirements in ~~OMB Circular A-133~~ *the Uniform Guidance* for the auditor to
- perform specified procedures to identify major programs.
 - follow up on prior audit findings and perform procedures to assess the reasonableness of the summary schedule of prior audit findings. (Ref: par. .21)

[No proposed amendments to paragraphs .A27–[A33].]

Reporting

- ~~.A34~~ *An appropriate heading for the “Opinion” section indicates the level specified by the governmental audit requirement. For example, an appropriate heading for reports on compliance audits under the Uniform Guidance would be “Opinion on Each Major Federal Program.” (Ref: par. .30d)*
- ~~.A35~~ *AU-C section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, requires that, on or before the date of the auditor’s report, the engagement partner, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor’s report to be issued.^{fn 18} When an engagement quality control review is performed, AU-C section 220 requires that the auditor’s report not be released prior to the completion of the engagement quality control review.^{fn 19} (Ref: par. .30m)*

^{fn18} See paragraph .19 of AU-C section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, for further discussion.

^{fn19} Paragraph .21 of AU-C section 220.

[Extant paragraph [.A34](#) is renumbered as paragraph A36. The content is unchanged.]

- ~~.A35~~~~A37~~ When the auditor communicates significant deficiencies or material weaknesses in internal control over compliance *findings* to management and those charged with governance, *Government Auditing Standards* also requires the auditor to obtain *and report views of* response from the responsible officials, preferably in writing, concerning their views on the findings, conclusions, and recommendations included in the auditor’s

report *as well as any planned corrective actions on internal control over compliance* and include a copy of any written response in the auditor's report.^{fn 1820} (Ref: par. .36)

^{fn 1820} See the "Reporting Views of Responsibilities *Responsible* Officials" section of *Government Auditing Standards*.

~~.A3638~~ If such a written response is included in a document containing the auditor's written communication to management and those charged with governance concerning identified significant deficiencies or material weaknesses in internal control over compliance *views of responsible officials are included in the auditor's report or in an auditor-prepared document required by a governmental audit requirement that is incorporated by reference in the auditor's report*, the auditor may add a paragraph to the auditor's written communication disclaiming an opinion on *management's response* such information. Following is an example of such a paragraph: (Ref: par. .3436)

Government Auditing Standards require the auditor to perform limited procedures on *Example Entity's ABC Agency's* written response to the significant deficiencies ~~[and material weaknesses]~~ *[insert type of finding(s) such as noncompliance or in internal control over compliance]* *finding(s)* identified in our compliance audit *is described in the accompanying [insert name of document]. Example Entity's response* was not subjected to the *other* auditing procedures applied in the compliance audit of *ABC Agency's* compliance and, accordingly, we express no opinion on ~~it~~ *the response*.

[No proposed amendments to paragraphs .A37–.A39, renumbered as paragraphs .A39–.A41.]

~~.A40~~ An example of an auditor-prepared document required by a governmental audit requirement that is incorporated by reference in the auditor's report is the schedule of findings and questioned costs in a compliance audit under ~~OMB Circular A-133~~ *the Uniform Guidance*.

Appendix — AU-C Sections That Are Not Applicable to Compliance Audits

~~.A41~~ The following AU-C sections and individually enumerated requirement paragraphs of specific AU-C sections are not applicable to a compliance audit performed under this section either because (a) they are not relevant to a compliance audit environment, (b) the procedures and guidance would not contribute to meeting the objectives of a compliance audit, or (c) the subject matter is specifically covered in this section. Where the table in this appendix specifies individual requirement paragraphs, rather than an entire AU-C section, the application and other explanatory material paragraphs related to such requirement paragraphs also do not apply. However, an auditor may apply these AU-C sections and paragraphs if the auditor believes doing so will provide appropriate audit evidence in the specific circumstances to support the auditor's opinion on compliance.

AU-C 935
ASB Meeting, March 11, 2020

<i>AU-C Section</i>	<i>Paragraphs Not Applicable to Compliance Audits</i>
210, <i>Terms of Engagement</i>	Paragraphs .06a and .08a
240, <i>Consideration of Fraud in a Financial Statement Audit</i>	Paragraphs .26 and .32b
250, <i>Consideration of Laws and Regulations in an Audit of Financial Statements</i>	All
315, <i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i>	Paragraphs .12c, .26–.27 30 , and .33c
330, <i>Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</i>	Paragraphs .13–.14, .19–.21, .26, and .31–.32
501, <i>Audit Evidence — Specific Considerations for Selected Items</i>	All
505, <i>External Confirmations</i>	All
510, <i>Opening Balances — Initial Audit Engagements, Including Reaudit Engagements</i>	Paragraphs .06, .08–.13, and .15–.17
540, <i>Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures</i>	All
550, <i>Related Parties</i>	All
560, <i>Subsequent Events and Subsequently Discovered Facts</i>	Paragraphs .09–.11 and .19–.20
570, <i>The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern</i>	All
600, <i>Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)</i>	Paragraphs .25a, .38, .40c, .54, and .55c . 26, .39, .41c, 41d, .55, and .56c.
700, <i>Forming an Opinion and Reporting on Financial Statements</i>	Paragraphs .14 .18, .22 .42, and .44 –.59 . 13–.17, .21–.4144, and .45–.60 61
701, Communicating Key Audit Matters in the Independent Auditor's Report	All
703, Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA	All
705, <i>Modifications to the Opinion in the Independent Auditor's Report</i>	Paragraphs .18–.20
706, <i>Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report</i>	Paragraphs .08–.09
708, <i>Consistency of Financial Statements</i>	All

Commented [AG14]: Correction to align with the paragraphs considered not applicable in AU-C 700A

AU-C 935
ASB Meeting, March 11, 2020

<i>AU-C Section</i>	<i>Paragraphs Not Applicable to Compliance Audits</i>
<i>720, Other Information in Documents Containing Audited Financial Statements</i>	All
<i>725, Supplementary Information in Relation to the Financial Statements as a Whole</i>	All
<i>730, Required Supplementary Information</i>	All
<i>800, Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks</i>	All
<i>805, Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement</i>	All
<i>806, Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements</i>	All
<i>810, Engagements to Report on Summary Financial Statements</i>	All
<i>910, Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country</i>	All
<i>915, Reports on Application of Requirements of an Applicable Financial Reporting Framework</i>	All
<i>920, Letters for Underwriters and Certain Other Requesting Parties</i>	All
<i>925, Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933</i>	All
<i>930, Interim Financial Information</i>	All
<i>940, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements</i>	All
945, Auditor Involvement With Exempt Offering Documents	All

Exhibit — Illustrative Combined Report on Compliance With Applicable Requirements and Internal Control Over Compliance — (Unmodified Opinion on Compliance, No Material Weaknesses or Significant Deficiencies in Internal Control Over Compliance Identified)

~~A4244~~ The following is an illustrative combined report on compliance with applicable requirements and internal control over compliance that contains the elements in paragraphs .30–.34. This illustrative report contains an unmodified opinion on compliance with no material weaknesses or significant deficiencies in internal control over compliance identified. The AICPA Audit Guide Government Auditing Standards and ~~Circular A-133~~ **Single Audits** contains illustrative language for other types of reports, including reports containing qualified or adverse opinions on compliance with either material weaknesses in internal control over compliance, significant deficiencies in internal control over compliance, or both identified.

Independent Auditor’s Report

[Addressee]

Report on Compliance

Opinion on [indicate the reporting level pursuant to governmental audit requirement]

We have audited Example Entity’s compliance with the [identify the applicable compliance requirements or refer to the document that describes the applicable compliance requirements] applicable to Example Entity’s [identify the government program(s) audited or refer to a separate schedule that identifies the program(s)] for the year ended June 30, 20X1.

Management’s Responsibility

~~Compliance~~ **In our opinion, Example Entity complied, in all material respects,** with the requirements referred to above ~~is~~ **that are applicable to** [indicate the reporting level pursuant to governmental audit requirement] **for the year ended June 30, 20X1.**

Auditor’s Responsibility

Basis for Opinion

~~Our responsibility is to express an opinion on Example Entity’s compliance based on our audit.~~

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America (**GAAS**); the standards applicable to financial audits contained in *Government Auditing Standards*^{fm+1} (**Government Auditing Standards**) issued by the Comptroller General of the United States; and [insert the name of the governmental audit requirement or program-specific audit guide]. **Our**

^{fm+1} The standards applicable to financial audits are in chapters 1–5 of *Government Auditing Standards*.

responsibilities under those standards and [insert the name of the governmental audit requirement or program-specific audit guide] are further described in the Auditor's Responsibilities for the Audit of Compliance section of our report.

We are required to be independent of Example Entity and to meet our other ethical responsibilities, in accordance with relevant ethical requirements relating to our audit. We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion. Our audit does not provide a legal determination of Example Entity's compliance with the compliance requirements referred to above.

Responsibilities of Management for Compliance

Management is responsible for compliance with the requirements referred to above and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to the Example Entity's government programs.

Auditor's Responsibilities for the Audit of Compliance

~~Those standards and [insert the name of the governmental audit requirement or program-specific audit guide] require that we plan and perform the audit.~~ ***Our objectives are** to obtain reasonable assurance about whether **material** noncompliance with the compliance requirements referred to above that ~~could have a material effect on~~ **are applicable to** [identify the government program(s) audited or refer to a separate schedule that identifies the program(s)] occurred, **whether due to fraud or error, and express an opinion on Example Entity's compliance based on our** ~~An audit includes.~~ ***Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS, Government Auditing Standards; and [insert the name of the governmental audit requirement or program-specific audit guide] will always detect material noncompliance when it exists. The risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Noncompliance with the compliance requirements referred to above is considered material if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made about compliance with the requirements of the government program as a whole by a reasonable user of the report on compliance.****

In performing an audit in accordance with GAAS, Government Auditing Standards, and [insert the name of the governmental audit requirement or program-specific audit guide], we

- *exercise professional judgment and maintain professional skepticism throughout the audit.*
- *identify and assess the risks of material noncompliance whether due to fraud or error and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence about regarding Example Entity's compliance with these the applicable compliance requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Example Entity's compliance with those requirements.*

Opinion

- *In our opinion, Example Entity complied, in all material respects, ~~obtain an understanding of~~ with the compliance requirements referred to above and Example Entity's internal control over compliance relevant to the audit in order to design audit procedures that are applicable to appropriate in the circumstances and to test and report on internal control over compliance in accordance with [insert the name of the governmental audit requirement or program-specific audit guide] for the year ended June 30, 20X1, but not for the purpose of expressing an opinion on the effectiveness of Example Entity's internal control over compliance. Accordingly, no such opinion is expressed.*

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that we identified during the audit.

Report on Internal Control Over Compliance

Management of Example Entity is responsible for establishing and maintaining effective internal control over compliance with the compliance requirements referred to above. In planning and performing our audit, we considered Example Entity's internal control over compliance to determine the auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Example Entity's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance on a timely basis. A *material weakness* in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis. A

Commented [AG15]: To align with definition in par. 11 of AU-C 935.

significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the Auditor's Responsibilities for the Audit of Compliance section above and was not designed to identify all deficiencies in internal control **over compliance** that might be ~~deficiencies, significant deficiencies, or~~ material weaknesses **or significant deficiencies** in internal control over compliance. Given these limitations, during our audit we did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. **However, material weaknesses or significant deficiencies in internal control over compliance may exist that have not been identified.**

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~~ **Accordingly, no such opinion on the effectiveness of Example Entity's internal control over compliance is expressed.**

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the *[insert the name of the governmental audit requirement or program-specific audit guide]*. Accordingly, this report is not suitable for any other purpose.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

4. This amendment is effective for compliance audits for fiscal periods ending on or after December 15, 2020. Early implementation is not permitted.