

# SAS 112

Communicating Internal Control Related Matters  
Identified in an Audit  
After December 15, 2006

# New Definitions

- Old Language
  - Reportable Condition
  - Material Weakness
- New Language
  - Significant Deficiencies
  - Material Weakness

	Old Definitions	New Definitions
Likelihood of internal control issue being reported	Material Weakness (Communicated)	Material Weakness (Reported in writing)
	Reportable Condition (Communicated)	Significant Deficiencies (Reported in writing)
	Management Letter Comment (possible separate communication to management)	Other matters related to Internal Controls (may be communicated)

# A Control Deficiency

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- Design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

Can either be in the design of the control or the operation of the control.

# Significant Deficiency

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- Control deficiency or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with GAAP such that there is more than a remote likelihood that a misstatement of the entity's financial statement that is more than inconsequential will not be prevented or detected.

# Material Weakness

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- A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statement will not be prevented or detected.

Significance of a control deficiency is dependent on the potential for misstatement, not whether a misstatement actually occurred.

Likelihood of Misstatement	Magnitude of Potential or Actual Misstatement		
	Clearly inconsequential (< 5%)	More than inconsequential, but less than material (5%-10%)	Material (> 10%)
Remote	Control deficiency	Control deficiency	Control deficiency
More than remote (at least reasonably possible)	Control deficiency	<b><u>Significant Deficiency</u></b>	<b><u>Material Weakness</u></b>

# DEFICIENCIES IN THE DESIGN

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- Inadequate design of internal control over the preparation of the financial statements being audited.
- Employees or management who lack the qualifications and training to fulfill their assigned function. (Accountant preparing FS in accordance with GAAP.)

# FAILURES IN OPERATIONS

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- Failure to perform reconciliations of significant accounts. (Reconcile AR to general ledger in a timely or accurate manner.)
- Failure in the operation of effectively designed control. (Dual authorization for significant disbursements processed with only one signature.)



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Communication must be  
in writing.

To those charged with Governance  
Within 60 days of report release

# Auditor cannot be part of the internal controls

In the past clients have relied on the auditors expertise and knowledge to prepare the proper financial statements. By doing this, they have made the auditors part of the internal control system.

What the auditor does is independent of the client's internal control and therefore cannot be a compensating control



SMITH MARION & Co.  
CERTIFIED PUBLIC ACCOUNTANTS

# Our Approach

To limit the possibilities of an internal control finding in your audit report

# Currently being done

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- Month to month reconciliation of key accounts
- Year end adjustments (Compensated Absences, Depreciation, A/P, and A/R)
- Audit workpapers (Depreciation schedules, Aging A/P & A/R list, loan amortization schedules).
- Compilation report omit disclosures.

General controls to limit Audit Adjustments

# New Work Proposed

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- Prepare full disclosure financial statements annually.
- Statement of Financial Position, Activities, and Cash Flows
- Notes to Financial Statements
- Schedule of Federal Awards
- Statement of Functional Expenses