

## Statement of Auditing Standards (SAS) 112

### Communicating Internal Control Related Matters Identified in an Audit

- Reinforces the responsibility of management for their internal control systems and the auditor's responsibility to report deficiencies in internal control to management.
- Written communication of significant deficiencies and material weaknesses is required (an SAO audit finding)
- **Significant deficiency** –a control deficiency that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably. A deficiency where it is at least reasonably possible that a misstatement of the entity's financial statements that is more than clearly immaterial will not be prevented or detected.
- **Material weakness** – a significant deficiency that results in a more than remote likelihood that a material misstatement of the financial statements will not be prevented or detected.
- The emphasis of the auditor's evaluation of a control deficiency is the potential for a misstatement rather than whether one has actually occurred.
- The standard considers deficiencies in these areas ordinarily as at least significant deficiencies:
  - Controls over the selection and application of accounting principles
  - Antifraud programs and controls
  - Controls over non-routine and nonsystematic transactions (journal entries etc.)
  - Controls over the period-end financial process (preparation of the financial statements)
- Some examples included in the SAS of “an indicator of a control deficiency should be regarded as a significant deficiency and a strong indicator of a material weakness” (not all-inclusive):
  - Ineffective oversight of the entity's financial reporting and internal control by those charged with governance.
  - Failure by management or those charged with governance to address a significant deficiency communicated to them in the past
  - Identification by the auditor of a material misstatement in the financial statements under audit that was not initially identified by the entity (even if the entity subsequently corrects it). (**State Auditor's Office interpretation – All reports and balances received for audit are in final form unless the entity specifically identifies items as “draft”.**)
- Some examples included in the SAS that may be control deficiencies, significant deficiencies or material weaknesses (not all-inclusive):
  - Inadequate design of internal control over a significant account, process or the preparation of financial statement being audited.
  - Employees or management who lack the qualifications and training to fulfill their assigned functions.
  - Absent or inadequate segregation of duties within a significant account or process.
  - Failure to perform reconciliations of significant accounts.