


## Application of SAS 112 In a Single Audit

GAQC Member Conference Call  
January 15, 2008  
Presented by  
Mandy Nelson, CPA  
George Rippey, CPA



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## What We Will Cover

- SAS 112 Background
- Refresher on SAS 112 Impact on Yellow Book Financial Statement Audits
- Implications of SAS 112 on Single Audits
- Evaluating Control Deficiencies in a Single Audit
- Updated Circular A-133 Illustrative Auditor's Reports



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## What We Will Not Cover?

- SAS 112 implications in a financial statement audit
  - Covered in a previous Center member-only call titled, "Impact of SAS 112 on Governmental Financial Audits"
  - To access that call visit:  
<http://gaqc.aicpa.org/Resources/Impact+of+SAS+112+on+Governmental+Financial+Audits+Conference+Call.htm>
  - Call is open to the general public so that your staff and clients can listen



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### SAS 112 Background

- In May 2006, the AICPA Auditing Standards Board (ASB) issued SAS No. 112, *Communicating Internal Control Related Matters Identified in an Audit*
- Conformed definitions of *control deficiency*, *significant deficiency*, and *material weakness* to those in PCAOB AS#2. The term *significant deficiency* replaced the term *reportable condition*
- Written from the perspective of internal control over financial reporting
- Was effective for audits of periods ending on or after December 15, 2006




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### Refresher: SAS 112 Impact on Yellow Book Financial Statement Audit

- 2007 Revision to the *Government Auditing Standards* (Yellow Book) adopted SAS 112 terminology and definitions
- Consistent with effective date of SAS 112, auditors should:
  - Report all significant deficiencies and material weaknesses in the Yellow Book report




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### Implications of SAS 112 on Single Audits

- Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, previously required the auditor to report *reportable conditions* and *material weaknesses* in internal control over compliance
- Determination had to be made of whether and how the SAS would impact reporting on internal control over compliance
- Task force of CPA firm members, state auditors, federal agency representatives, and GAQC staff established; George Rippey chaired the effort and Mandy Nelson served as a member




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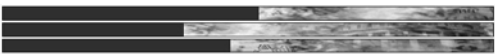
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### Implications of SAS 112 on Single Audits

- Overall response:
  - OMB Notice in the Federal Register revised Circular A-133 to require internal control terminology consistent with SAS 112
  - The ASB issued an auditing interpretation which defines the terms *control deficiency*, *significant deficiency*, and *material weakness* from the perspective of reporting on internal control over compliance in a Circular A-133 audit
  - Updated illustrative Circular A-133 auditor reports that reflect the new terminology and definitions were issued
  - Other interpretive guidance relating to the evaluation of control deficiencies relating to internal control over compliance was developed




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### OMB Circular A-133 Amendment

- Terminology updates relating to internal control over financial reporting:
  - Circular A-133 references "reportable conditions" and "material weaknesses" in the Circular are replaced with the terms "significant deficiency" and "material weakness" as those terms are defined in SAS 112 and the 2007 revision to *Government Auditing Standards*




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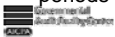
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### OMB Circular A-133 Amendment

- Terminology updates relating to internal control over compliance:
  - Amendment states that the terms "reportable condition" and "material weakness" are replaced with the updated terminology and definitions in the AICPA SAS 112 auditing interpretation issued concurrently with the amendment to Circular A-133
- These changes are effective for single audits of periods ending on or after December 15, 2006




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### OMB Acknowledges

- Changes in terminology and definitions could affect the scope of future single audits in that under the Circular:
  - Type A program can not be considered low-risk if it had a significant deficiency
  - An entity is not able to be a low-risk auditee if it had deficiencies in I/C over financial reporting that would be considered material weaknesses or if any of the federal programs (that were classified as Type A programs) had material weaknesses (in either of the 2 preceding years)




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### FYI: Other Changes Made in Circular A-133 Amendment

- Instructions for Data Collection Form provided
- Changes to an auditee's submission of the reporting package to the Clearinghouse




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### AICPA's Auditing Interpretation

- Establishes definitions for the terms *control deficiency*, *significant deficiency*, and *material weakness* when the auditor is reporting control deficiencies that relate to internal control over compliance in a Circular A-133 audit




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### Single Audit Definitions

- A *control deficiency* exists when the 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 on a timely basis noncompliance with a type of compliance requirement of a federal program



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### Single Audit Definitions

- A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected



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### Single Audit Definitions

- A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected



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### Evaluating Control Deficiencies In a Single Audit

- AICPA task force also looked at SAS 112 evaluation guidance to see how it could be applied when evaluating deficiencies in internal control over compliance in a single audit
- Developed evaluation guidance that was published in the 2007 AICPA Audit Risk Alert (ARA), *Government Auditing Standards and Circular A-133 Audits* (GAS-A133 Alert) and made available to GAQC members in *GAQC Alert 62*
- You may also want to refer to the handout material as we go through the next slides




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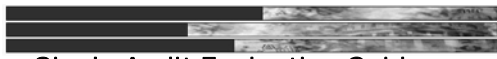
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### Single Audit Evaluation Guidance

- In a single audit
  - The significance of a control deficiency depends on the potential for noncompliance and not on whether noncompliance actually has occurred
  - The absence of identified noncompliance does not provide evidence that identified control deficiencies are not significant deficiencies or material weaknesses
  - The auditor should consider the likelihood and magnitude of actual or potential noncompliance when evaluating whether control deficiencies, individually or in combination, are significant deficiencies or material weaknesses




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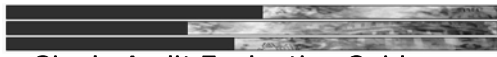
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### Single Audit Evaluation Guidance

- Factors that may affect the **likelihood** that a control, or combination of controls, could fail to prevent or detect noncompliance:
  - The nature of the type of compliance requirement involved (e.g., special tests and provisions may be higher risk)
  - The susceptibility to fraud
  - The subjectivity and complexity, and the extent of judgment allowed
  - The cause and frequency
  - The interaction or relationship of the control with other controls
  - The interaction of the control deficiency with other control deficiencies
  - The possible future consequences of the deficiency




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### Single Audit Evaluation Guidance

- Factors that may affect the *magnitude* of noncompliance when evaluating control deficiencies include, but are not limited to, the following:
  - The program amounts or total of transactions exposed to the deficiency
  - The volume of activity exposed to the deficiency in the current period or expected in future periods
  - Adverse publicity or other qualitative factors




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### Single Audit Evaluation Guidance

- The following guidance/concepts in SAS 112 also apply in a single audit:
  - Compensating controls
  - Deviations in the operating effectiveness of controls
  - Prudent official test




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### Examples of Significant Deficiencies In Internal Control Over Compliance

- For purposes of deficiencies in a single audit the following areas ordinarily are at least significant deficiencies in internal control:
  - Policies and procedures which are incomplete, inadequate, or outdated for the activities subject to a type of compliance requirement
  - Inadequate segregation of duties over a type of compliance requirement
  - Controls over complex types of compliance requirements
  - IT controls relating to the activity subject to the type of compliance




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**At Least a SD and a Strong Indicator of a MW in Internal Control Over Compliance**

- Lack of operating policies and procedures for the activities subject to a type of compliance requirement
- Ineffective oversight of a major federal program by those charged with governance over compliance with those program requirements where the activity is subject to the type of compliance requirement, e.g., lack of adequate review of federal financial reports prior to submission to the grantor
- Identification by the auditor of material noncompliance for the period under audit that was not initially identified by the entity's internal control. (This is a strong indicator of a material weakness even if management subsequently corrects the noncompliance.)




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**At Least a SD and a Strong Indicator of a MW in Internal Control Over Compliance**

- An ineffective internal audit function or risk assessment function for a major program for which such functions are important to the monitoring or risk assessment component of internal control for a type of compliance requirement
- Identification of fraud in the major program of any magnitude on the part of senior program management. For the purposes of evaluating and communicating deficiencies in internal control, the auditor should evaluate fraud of any magnitude—including fraud resulting in immaterial noncompliance—on the part of senior program management, of which he or she is aware




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**At Least a SD and a Strong Indicator of a MW in Internal Control Over Compliance**

- Failure by management or those charged with governance to assess the effect of a significant deficiency previously communicated to them and either correct it or conclude that it will not be corrected
- An ineffective control environment. Control deficiencies in various other components of internal control could lead the auditor to conclude that a significant deficiency or material weakness exists in the control environment over compliance with major program requirements




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### Circular A-133 Illustrative Auditor's Reports

- The AICPA Audit Guide, *Government Auditing Standards and Circular A-133 Audits*, with conforming changes as of May 1, 2007, includes *Government Auditing Standards* and Circular A-133 illustrative reports updated for SAS 112
- Reports excerpted from the Guide can also be found at GAQC Web site at: <http://gaqc.aicpa.org/Resources/Illustrative+Auditors+Reports/> for your convenience




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### Other Federal Agencies

- The U.S. Department of Housing and Urban Development (HUD) issued an update to its *Consolidated Audit Guide* (the HUD Guide) to provide users with illustrative internal control reports that contain SAS 112 language
- HUD posted links to the reports on its web site at <http://www.hud.gov/offices/oig/reports/auditguide/>
- It is anticipated that other Federal agencies will update audit guides to incorporate SAS 112 language.




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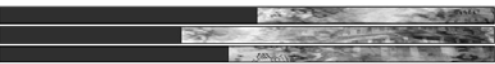
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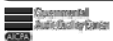
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Questions ?????




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