



# Understanding the Implications of SAS #112

Robert Dwan  
Associate Executive Director  
MSBO

**The Effects of SAS No. 112**

Robert K. Dwan  
Associate Executive Director  
MSBO

---

---

---

---

---

---

---

---

**Objectives**

- For you to gain an understanding of the audit standards affecting your audit engagement and the impacts and potential outcomes that result from this standard

---

---

---

---

---

---

---

---

**Why A New Standard?**

- The accounting profession believes SAS No. 112 may:
  - Heighten your awareness of internal control over financial reporting
  - Increase your competency level on internal control over financial reporting
  - Enable management and those charged with governance to better assess the costs and benefits of implementing any new controls that would help minimize the risks of financial statement misstatements, including fraud

---

---

---

---

---

---

---

---

## What is SAS No. 112?

- ▶ Statement on Auditing Standards (SAS) No. 112, *Communication of Internal Control Related Matters Identified in an Audit* - December 15, 2006
- ▶ Superseded SAS No. 60
- ▶ Establishes standards and provides guidance on communicating matters related to an entity's internal control over financial reporting identified in an audit of financial statements

---

---

---

---

---

---

---

---

## Components of SAS No. 112

- ▶ The auditor must evaluate identified control deficiencies
- ▶ Then determine whether those deficiencies, individually or in combination, are **significant deficiencies** or **material weaknesses**
- ▶ The auditor must communicate, **in writing**, significant deficiencies and material weaknesses to management and those charged with governance

---

---

---

---

---

---

---

---

## Components of SAS No. 112

- ▶ This communication includes significant deficiencies and material weaknesses identified and communicated to management and those charged with governance in prior audits but not yet remediated

---

---

---

---

---

---

---

---

**SAS 112** Communicating Internal Control Related Matters Identified in an Audit

▶ New definitions of “control deficiencies”

|   | Old (SAS 60)  | New (SAS 112)   |
|---|---|---|
| + | Material Weakness – (Communicated)                                  | Material Weakness – (Reported in writing)   |
| – | Reportable Condition – (Communicated)                               |   |
|   | Management Letter – (Possible separate communication to management) | Significant Deficiency – (Reported in Writing)<br>Other Matters – (May be communicated) |

---

---

---

---

---

---

---

---

---

---

**Definitions**

▶ **Control Deficiency**

▶ 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 misstatements on a timely basis

---

---

---

---

---

---

---

---

---

---

**Definitions**

▶ **Significant Deficiency**

▶ A significant deficiency is a 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 generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity’s financial statements that is more than inconsequential will not be prevented or detected by the entity’s internal control

---

---

---

---

---

---

---

---

---

---

## Definitions

- ▶ **Material Weakness** - A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control

---

---

---

---

---

---

---

---

## Control Deficiencies

- ▶ Material Weakness
- ▶ Significant Deficiencies
- ▶ Other Matters

---

---

---

---

---

---

---

---

## Examples of Control Deficiencies

- ▶ Examples of circumstances that may be control deficiencies, significant deficiencies, or material weaknesses include:
  - 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 functions

---

---

---

---

---

---

---

---

### Examples of Control Deficiencies

- Inadequate design of information technology (IT) general and application controls
- Inadequate documentation of the components of internal control
- Inadequate design of monitoring controls that assess the design and operating effectiveness of the entity's internal control over time
- Inadequate design of internal control over a significant account or process

---

---

---

---

---

---

---

---

### Examples of Control Deficiencies

- Absent or inadequate segregation of duties within a significant account or process
- Absent or inadequate controls over the safeguarding of assets

---

---

---

---

---

---

---

---

### Significant Deficiencies

- SAS 112 identifies areas in which deficiencies ordinarily are considered to be at least significant deficiencies and the two that are most likely to occur are:
  - Controls over the selection and application of accounting principles in conformity with GAAP
  - Controls over the period-end financial reporting process
    - Includes controls over procedures for entering totals into the General Ledger; initiating, authorizing, recording and processing journal entries into the General Ledger; and recording recurring and nonrecurring adjustments to the financial statements

---

---

---

---

---

---

---

---

## Material Weaknesses

- ▶ SAS 112 identifies indicators of deficiencies that are at least significant deficiencies and strong indicators of a material weakness and the two that are most likely to occur are:
  - Ineffective oversight of financial reporting and internal control by those charged with governance
  - Identification by the auditor of a material misstatement in financial statements not initially identified by the entity's internal control

---

---

---

---

---

---

---

---

## An Illustrative Example – #1

- ▶ The District has requested that the auditor perform the functions necessary to prepare the District's financial statements since the District does not have the resources with the adequate knowledge to prepare the District's financial statements according to generally accepted accounting principles

---

---

---

---

---

---

---

---

## An Illustrative Example – #2

- ▶ The controller asks the auditor to calculate the year-end depreciation adjustment and gain or loss on sale adjustment
  - The adjustment is a material adjustment
  - The controller did not have the skill to determine the adjustment

---

---

---

---

---

---

---

---

### **An Illustrative Example – #3**

- ▶ The bookkeeper, who maintains the company's general ledger, is unable to record the investments and related investment activity because he does not understand the broker's statement

---

---

---

---

---

---

---

---

### **Evaluating Control Deficiencies**

- In any given example, remember, the auditor will determine the likelihood and magnitude of a misstatement to determine if it is a significant deficiency or material weakness

---

---

---

---

---

---

---

---

### **Communicating Deficiencies**

- ▶ Auditors are only required to communicate in writing those control deficiencies identified during the audit and determined to be significant deficiencies or material weaknesses
- ▶ They will include significant deficiencies or material weaknesses identified during this audit that we may have previously communicated, whether verbally or in writing, that are not yet remedied

---

---

---

---

---

---

---

---

Thank You and Enjoy the  
Workshop

---

---

---

---

---

---

---

---