



.....
Updates to Communications on Internal Control – SAS No. 115
.....

New guidance has been released related to the auditor’s communications on internal control, which is included in the auditor’s communication with those charged with governance (also known as management letter comments). The guidance is effective for audits of financial statements for periods ending on or after December 15, 2009.

The auditor is not required to perform procedures identifying deficiencies internal control, nor is the auditor required to express an opinion on the effectiveness of the entity’s internal control. However, if deficiencies in internal control are identified during the audit procedures, these should be communicated with those charged with governance, which may be the board of directors or an audit committee.

The auditor may identify a deficiency in *design*, which would be if a control is missing or an existing control is not properly designed so that the control objectives may not be met. Alternatively, a deficiency in *operation* exists when the 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.

The definitions for a material weakness and significant deficiency have been modified under the new guidance of SAS No. 115 as follows:

- *Material Weakness* – deficiency or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis.
- *Significant Deficiency* – deficiency or combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Your auditor should evaluate the severity of each deficiency in internal control identified during the audit, with the severity depending on the magnitude of the potential misstatement resulting from the deficiency and whether there is a reasonable possibility that the entity’s controls will fail to prevent, or detect and correct a misstatement of an account balance or disclosure. It is very important for clients to realize that the severity of the deficiency does not depend on whether a misstatement actually occurred. There are several factors that the auditor considers when determining the severity of the deficiency, including the volume of the activity for the account, the financial statement balance for the account, the susceptibility of the related asset or liability to loss or fraud, and the interaction among the deficiencies.

.....
Author:
Jennifer Osburn, CPA

Your auditor is required to communicate, in writing, deficiencies identified during the audit. The communication should be to management and those charged with governance as part of each audit, including prior significant deficiencies and material weaknesses that were communicated in previous audits that have not been corrected. The communication should be released with the audited financial statements, but no later than 60 days following the financial statement report release date.