

SAS 112



In 2006 the American Institute of Certified Public Accountants issued new Statements on Auditing Standards (“SAS”) that drastically change the way in which audits are performed. All of these SAS affect how your auditor performs your audit but none more significantly than SAS 112. SAS 112 – *Communicating Internal Control Related Matters Identified in an Audit* requires that auditors must evaluate identified control deficiencies and determine whether those deficiencies, individually or in combination, are “significant deficiencies” or “material weaknesses” and communicate them in writing to management and those charged with governance. This includes current year findings and those from prior years which have not been corrected.

Control deficiencies exist 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.

A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects your 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 financial statements that is more than inconsequential will not be prevented or detected.”

A material weakness is a significant deficiency, or a 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.

Though SAS 112 deals with internal controls in all functions of your operations, the one aspect of most concern is the preparation of the annual financial statements. SAS 112 states that if you cannot prepare your annual financial statements, including footnotes, there is a strong indication of a material weakness in internal controls which must be reported. Auditors are expected to audit the entity’s financial statements already prepared by our clients, not by the auditor. The inability to prepare financial statements is an indication of a lack of controls, or ineffective controls, because material misstatements would not be detected.

The options available under SAS 112 are:

- you prepare your financial statements and have them available for audit,
- you hire an appropriately experienced expert to prepare the financial statements,
- you obtain training to enable you to prepare your financial statements (although you can then engage your auditor to draft them subject to your review), or
- your auditor prepares the financial statements and a material weakness will be communicated.

The last option is not recommended.

If you choose not to hire an independent expert to prepare your annual financial statements for audit or to hire a staff member to do so, someone in your employ should take continuing education courses on the preparation of financial statements. Once training is received, you and your auditor can honestly say that someone in the employ of the entity understands how to prepare the financial statements and can take responsibility for them.

Someone in-house must be able to detect a material misstatement in the financial statements. If proper training has occurred, your auditor can continue to prepare the draft financial statements without reporting a material weakness in your internal controls.

If you are fortunate enough to have an experienced CPA on your Board who is willing to serve as your member of management with appropriate experience to review and take responsibility for your financial statements, then you do not have to worry about your inability to prepare your financial statements. However, despite the presence of an experienced CPA on your Board, you should consider having at least one member of your staff trained in financial statement preparation.

Your auditor wants to work with you on how we can be true to the intent of Statement 112 while not overtaxing you. With training in the preparation of your financial statements, we can honestly say that you could prepare the financial statements, but have asked us to prepare them due to time restraints. Thus, there would be no material weakness in future years.

There are other steps that you can take now to ensure that material weaknesses are not cited in future audits.

- Educate your Board as to what a control deficiency, significant deficiency, and material weakness are. Training will give your Board a chance to improve controls to avoid future comments.
- Take stock of significant accounts, disclosures, as well as processes and cycles. Assess how your financial information is recorded and reported and look at key activities to make sure internal controls are in place and functioning.
- Review internal controls in these key areas: financial closing process, information technology controls over significant systems such as payroll or your general ledger, and capital assets.

If you would be interested in attending a class on financial statement preparation, please fax or mail the form below to Dawn M. Minemier, CPA by November 15th. If there is enough interest, we will offer a half-day class in early 2008. The class will focus on things you as a client would be required to do in order to prove that you have the knowledge to prepare your financial statements. We will offer one class for governmental entities and one for not-for-profits, if there is enough interest.

----- ✂ ----- **SAS 112 Class Interest Form** ----- ✂ -----

Name(s) _____

Organization Name _____

Address _____

Phone _____

Estimated Number Attending _____

- Governmental class
- Not-for-profit class

Comments: