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## Understanding How SAS 112 Helps Decision-makers

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In response to scandals such as Enron and Worldcom, several new pronouncements have changed the way in which audits are conducted. One is the *Statement on Auditing Standards No. 112, Communicating Internal Control Related Matters Identified in an Audit*, also known as SAS 112. As the name indicates, the goal is to improve communication about the findings of an audit. Specifically, it ensures that auditors communicate any significant control deficiencies to the client. Under SAS 112, an auditor is required to 1) assess any control deficiencies, 2) determine the significance of such deficiencies, and 3) communicate significant deficiencies to the client.

An example of a typical control deficiency would be a lack of segregation of duties in an accounting department. For example, if the person who receives customer payments also records and deposits them, then there are likely insufficient controls in place to prevent or detect misstatements on a timely basis. While an auditor is not required to search for these deficiencies, the auditor must make management aware of any deficiencies they may happen to identify in the course of an audit.

If a control deficiency is identified, then the auditor must determine how significant it is by assessing the likelihood and magnitude of a *potential* misstatement in the financial statements. A material "misstatement" is an error in the financial statements that makes it probable that the judgment of a reasonable user of the financial statements would have been changed or influenced by the error or omission. It is important to note that the misstatement does not actually have to occur for a control deficiency to be significant. It need only have the *potential* to occur.

If a potential misstatement is deemed to be more than a remote likelihood and more than inconsequential in magnitude, then a control deficiency is determined to be significant. A significant deficiency that results in more than a remote likelihood that a material misstatement will not be prevented or detected is a material weakness. Deficiencies that are significant or material must be communicated to management in what is known as a "SAS 112 letter". In some cases, control deficiencies may be the result of cost/benefit decisions that management has knowingly made. Other times, management is not aware that the control deficiency exists. In those instances, it would be appropriate to discuss the identified deficiency with your auditor to determine what action should be taken to mitigate or eliminate the control deficiency.

If you would like to discuss the SAS 112 requirements and letter further, contact Bill Jenczyk at [wjenczyk@dgccpa.com](mailto:wjenczyk@dgccpa.com).