Statement on Auditing Standards (SAS) No. 115
Communication of Internal Control Related Matters Identified in an Audit
Frequently Asked Questions
for AICPA PCPS Members

This SAS No. 115 Frequently Asked Questions for PCPS Members document is intended to address the most common practitioner questions related to this new standard that supersedes SAS No. 112. This document is intended to provide clarification on the key points of SAS No. 115 and direct you to valuable resources to help apply the new standard appropriately in your audits of your clients’ financial statements.

Keep in mind that to appropriately implement SAS No. 115, there are broader concepts that you must take into account including:

- Other existing SAS’s
- Ethics Interpretation 101-3 Performance of Nonattest Services
- COSO’s Internal Control – Integrated Framework

What is SAS No. 115?
SAS No. 115 supersedes SAS No. 112 and, “…further clarifies standards and provides guidance on communicating matters related to an entity’s internal control over financial reporting (internal control) identified in an audit of financial statements” according to the AICPA’s Audit Risk Alert “Communicating Internal Control Related Matters in an Audit - Understanding SAS No. 115”.

The Auditing Standards Board (ASB) issued SAS No. 115 to maintain consistency in the definitions of the kinds of deficiencies in internal control and the guidance provided for evaluating such deficiencies provided in the PCAOB Auditing Standard No. 5.

What’s changing as a result of SAS No. 115?
SAS No. 115 includes much of what was outlined in SAS No. 112 as it provides guidance to enhance the auditor's ability to evaluate deficiencies in internal control identified during an audit, and then communicate those deficiencies that the auditor believes are significant deficiencies or material weaknesses to management and those charged with governance.

The key differences between SAS No. 115 and SAS No. 112 are in the definitions of material weaknesses and significant deficiencies so they are aligned with the PCAOB Auditing Standard No. 5, with the most significant change being to the definition of significant deficiencies. Additional guidance for making the determination as to whether a deficiency is a material weakness or significant deficiency has also been updated.

What are the definitions of significant deficiency and material weakness?
The definitions of the significant deficiency and material weakness are found in the Statement on Auditing Standards No. 115, and include:
• “A material weakness is a 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.”

• The change in the definition of material weakness is that it distinguishes that a reasonable possibility exists, rather than “more than a remote likelihood” as stated in SAS No. 112 that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. This is consistent with the definition that the likelihood of a material misstatement is either reasonably possible or probable as defined in the Financial Accounting Standards Board (FASB) Statement No. 5, Accounting for Contingencies 1, 2. “A significant deficiency is a deficiency, or a 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.”

The change in the definition of significant deficiency from SAS No. 112 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” has been removed, giving the auditor the ability to apply more professional judgment in determining whether the deficiency is a significant deficiency and merits attention by the client’s management or those charged with governance. Magnitude and probability of a misstatement occurring still need to be assessed by the auditor, and, because SAS No. 112 was not intended to be a checklist for auditors, and auditors were expected to use their professional judgment, the indicators were removed to encourage professional judgment be applied to each case.

As with SAS No. 112, nothing is automatically a material weakness or significant deficiency. Instead, the auditor should evaluate the severity of each identified internal control deficiency and determine whether it is a significant deficiency or a material weakness based upon:

- The magnitude of the potential misstatement resulting from the deficiency or deficiencies; and
- Whether there is a reasonable possibility that the entity’s controls will fail to prevent, or detect and correct a misstatement

SAS No. 115 and the AICPA’s SAS No. 115 Risk Alert define how to evaluate a deficiency’s likelihood and magnitude and provide some examples of each. Similar to SAS No. 112, the severity of a deficiency does not depend on whether a misstatement actually occurred.

What is the change in the communication required in SAS No. 115?
Auditors are still required to communicate, in writing, any material weaknesses or significant deficiencies identified during the audit to management and those charged with governance. The two changes in the communication under SAS No. 115:
• Require a statement indicating that the auditor’s consideration of internal control during an audit was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses, but rather to assess the deficiencies in internal control that the auditor becomes aware of during the audit to determine whether the deficiency is a significant deficiency or material weakness.

• The illustrative report was revised to define material weaknesses first with the specific examples of the material weaknesses the auditor identified during the audit, if any, and then that any significant deficiencies found be defined second along with the specific examples of significant deficiencies the auditor identified, if any.

A sample communication is included in the SAS No. 115 and a modifiable letter template for communicating to your clients is included on the PCPS web site at [http://pcps.aicpa.org/Resources/A+and+A+Resources+Keeping+Up+With+Standards/](http://pcps.aicpa.org/Resources/A+and+A+Resources+Keeping+Up+With+Standards/).

**Is it likely that material weaknesses or significant deficiencies communicated to the client under SAS No. 112 will still need to be communicated under SAS No. 115?**

Most likely, auditors will find that deficiencies they determined as significant deficiencies or material weaknesses under SAS No. 112 will be the same under SAS No. 115. The difference is that rather than applying a checklist of possible examples for significant deficiencies that were outlined under SAS No. 112, SAS No. 115 increases the use of professional judgment by an auditor in determining whether a deficiency is a significant deficiency or not. Each deficiency needs to be evaluated on an individual basis by following the steps outlined in the AICPA’s SAS No. 115 and Risk Alert to determine the likelihood and magnitude of a misstatement occurring.

**Should an auditor communicate that there were no significant deficiencies if they do not identify any?**

No, similar to SAS No. 112, an auditor should not issues a communication stating that no significant deficiencies were found. If an auditor is asked to issue a communication stating no material weaknesses were found, a sample communication is provided in Exhibit A of the SAS No. 115.

**Is it necessary to reiterate deficiencies from prior years?**

Yes if those significant deficiencies or material weaknesses have not been remediated. Communicating deficiencies in writing until they are resolved highlights the importance of significant deficiencies or material weaknesses. According to SAS 115, significant deficiencies and material weaknesses that were previously communicated and have not been resolved may be communicated, in writing, by referring to the previously issued written communication and the date of that communication.

The auditor may inform the client that this communication will help ensure that management and those charged with governance understand areas of risks so that they’re able to make an informed cost benefit decision in response to those identified control weaknesses.
Will SAS No. 115 cause an increase of time and fees on an engagement?
When SAS No. 112 became effective, audit fees may have increased because of the requirement to communicate identified significant deficiencies and material weaknesses in writing. It is not expected that SAS No. 115 will drive any additional audit fee increases over and above the increases you may have experienced when implementing SAS No. 112.

What additional client communications or services may result from applying this standard?
SAS No. 115, as with SAS 112 provides the possibility of additional opportunities to provide valuable services to your clients that are not directly related to the audit engagement, which you should consider scoping as separate services from your audit engagement. If you have not explored these additional services since the implementation of SAS No. 112, they bear consideration. Such opportunities to provide additional services for your clients include:

- Additional education or meetings with clients and their stakeholders to discuss how an auditor views controls and why financial controls are important in producing reliable financial information. The discussion can include why you evaluated a control deficiency as a significant deficiency or material weakness and possible methods of mitigation. In addition, these educational sessions or meetings can help management and stakeholders understand why the auditor is not a part of their internal control system. These meetings may occur prior to, during, and after the completion of the audit engagement.
- Additional education or meetings with your clients to help them understand risk management. Risk management is important to any successful operation. While most small business owners understand risks to their business or operations and the importance of operational risk management, they may not consider financial reporting risks and how unmitigated financial reporting risks may lead to incorrect financial information and at worst, material fraud, including misappropriation of assets.
- Assisting the client in conducting a cost/benefit analysis to determine the advantage of implementing new or improved controls.
- Assistance in testing current controls or assistance in developing and implementing controls for clients.

What are the benefits of SAS No. 115 for clients?
The benefits of SAS No. 115 remain the same as they were under SAS No. 112. Primarily, both drive the client to better understand their organization’s internal control weaknesses which could benefit them in several ways, including:

- Written communication will clarify identified internal control deficiencies determined to be significant deficiencies or material weaknesses so management can weigh the risks of each and determine if and how to address them.
- Addressing the identified control deficiencies may result in reduced risks to the client’s business due to potential improved financial reporting processes and controls as well as smoother and more efficient audits in the future.
• Identifying significant deficiencies and material weaknesses during the audit could result in the client attaining higher internal control system, which will reduce the risks of financial misstatement and could be a deterrence to fraud.
• The client’s competency level on internal control over financial reporting may increase due to heightened awareness and education on internal control.

You can download a sample letter “Educating Your Client” at http://pcps.aicpa.org/Resources/A+and+A+Resources+Keeping+Up+With+Standards/. In addition, you may want to offer to set-up a meeting prior to the engagement to discuss and address any questions as well as allot additional time at the conclusion of the audit to address any questions or concerns that arise as a result of the audit.

What concerns does SAS No. 115 raise regarding the potential loss of services a practitioner can perform for his or her client (i.e., preparation of financial statements, making recommendations for adjusting journal entries, managing a client’s fixed assets schedule and making recommendations on the depreciation schedules and adjustments, etc.)?

As with SAS No. 112, SAS No. 115 does not affect which services an auditor can continue to provide to his or her client. The delivery of non attest services, as well as other services provided in conjunction with the audit engagement (e.g. assisting in drafting the financial statements, proposing adjustments to tax accounts), are permitted just as they were prior to SAS No. 112. The key is that the auditor is not making management decisions or acting as part of internal control for the client.

The AICPA’s Audit Risk Alert, “Communicating Internal Control Related Matters in an Audit - Understanding SAS No. 115” provides specific case studies to help determine whether identified control weaknesses would constitute a significant deficiency or material weakness. The Alert clarifies that what the auditor does is totally independent of a client’s internal control system. If the auditor is performing non attest services, he or she must rely on his/her judgment to determine whether the client has the suitable skills, knowledge and experience to review the services performed by the auditor. When providing any non-attest services, the auditor should refer to Ethics Interpretation 101-3 Performance of Nonattest Services for the appropriate guidelines in determining their independence on a service.

What are the guidelines to determine whether a client has sufficient accounting competence and knowledge to detect or prevent a misstatement or mistake (i.e., in the case of calculating the depreciation adjustment, preparing financials, etc)?

The auditor is not required to test the client’s competency. The client’s competency may be questioned if the auditor is unsure as to whether adequate controls are in place to prevent and detect financial misstatements. Often the client will request the auditor to perform certain services, not because the client doesn’t have controls in place, but for convenience when the client would rather apply their resources to other parts of the business. A potential control deficiency can be assessed by asking the following questions:

• Could the client perform the service themselves if the auditor did not do so?
• If the auditor performs the work, does the client possess the suitable skills, knowledge and experience to review the work in such a manner that the client’s controls would prevent or detect a material misstatement?
• Does the client have a process in place to review the work and are they doing so?

If the answer is no to any of these questions, then a control deficiency may exist that needs to be evaluated as to whether there is a control deficiency and if so is it a significant deficiency or material weakness. If it is determined to be either, it must be communicated in writing.

In addition, examples of circumstances that may be control deficiencies, significant deficiencies, or material weaknesses are outlined in the Statement on Auditing Standards No. 115 and in the case studies in the Risk Alert.

**The client has designated a person on staff to review the financial reports, adjustments, etc. that the auditor is providing. Is this considered an internal control?**
Assigning a designated person by itself is not a control. A control is the process or procedure that is carried out by an individual or third party to prevent or detect a misstatement. Controls are designed and executed to achieve control objectives. Control objectives are set forth to mitigate or limit identified or known risks.

**Can the auditor modify the sample communication in SAS No. 115?**
The sample report in SAS No. 115 is only illustrative and can be modified to meet the auditor’s needs; however, the auditor should include the following components outlined in the SAS No. 115 Risk Alert:

• “A statement that indicates the purpose of the auditor's consideration of internal control was to express an opinion on the financial statements, but not to express an opinion on the effectiveness of the entity's internal control.
• A statement that indicates the auditor is not expressing an opinion on the effectiveness of internal control.
• A statement that indicates that the auditor's consideration of internal control was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.
• The definition of the term *material weakness* and, where relevant, the definition of the term *significant deficiency*.
• Identification of the matters that are considered to be significant deficiencies and those that are considered to be material weaknesses.
• A statement that indicates the communication is intended solely for the information and use of management, those charged with governance and others within the organization and is not intended to be and should not be used by anyone other than these specified parties. If an entity is required to furnish such auditor communications to a governmental authority, specific reference to such governmental authorities may be made.”
The auditor discusses a draft report of deficiencies or weaknesses with management and management responds that they have sufficient controls or compensating controls in place. Should the auditor test the controls or the compensating controls? There is no requirement that the auditor test controls or compensating controls. However, if management wants the auditor to consider compensating controls in order to reduce the severity of a material weakness or significant deficiency, then the auditor will need to test the effectiveness of the compensating control. Additionally, the auditor may always arrange with their client to test design and/or operating effectiveness as a separate engagement.

What has changed for those performing governmental audits? The AICPA’s Governmental Audit Quality Center (GAQC) is determining the impact on yellow-book audits and will communicate any changes and examples through alerts to their members. For more information, visit www.aicpa.org/gaqc.

What is Internal Control Over Financial Reporting? The COSO Definition of Internal Control is a process, affected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations

COSO states that internal control over financial reporting is “…a process—effected by those charged with governance, management, and other personnel—designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations… the term financial reporting relates to the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles.”

COSO identifies the key concepts of internal control in the original 1992 framework (see COSO website at http://www.coso.org/key.htm) as:

- Internal control is a process. It is a means to an end, not an end in itself.
- Internal control is affected by people. It’s not merely policy manuals and forms, but people at every level of an organization.
- Internal control can be expected to provide only reasonable assurance, not absolute assurance, to an entity’s management and board.
- Internal control is geared to the achievement of objectives in one or more separate but overlapping categories.

For additional resources on internal control over financial reporting visit COSO or www.cpa2biz.com for the following resources as well as others, including:
• **Internal Control – Integrated Framework** (product no. 990012kk), a paperbound version of the COSO report that established a common definition of internal control different parties can use to assess and improve their control systems.

• **Internal Control and IT: Reliable Reporting and Fraud Prevention**, a CPE course that provides an overview of the key auditing standards, conceptual frameworks, IT infrastructures and auditing issues you are likely to face on medium to small company engagements. (Product no. 732551)

• **Internal Controls: Design and Documentation**, a basic course that explains what makes up an effective system and provides a toolkit of today’s current techniques for creating useful documentation. This course will benefit controllers, managers, and internal auditors in businesses as well as auditors and consultants to public and private companies who need a review. (Product no. 731852)

• **Internal Control Over Financial Reporting – Guidance for Smaller Public Companies** provides guidance on how to apply the COSO Framework. It was developed for smaller public companies using the Framework to design and implement internal control over financial reporting. (Product no. 990016HI)

**I still have questions. Where can I go for additional information?**

- To review the SAS No. 115 go to [Communicating Internal Control Related Matters Identified in an Audit - SAS No. 115](#).

- The AICPA’s Audit Risk Alert, **“Understanding SAS No. 115 and Evaluating Control Deficiencies”** can be purchased on [www.cpa2biz.com](http://www.cpa2biz.com) and provides additional guidance, relevant case studies and a comprehensive resource listing, including:
  - Publications listing
  - Webcasts
  - AICPA resource
  - Continuing education and online CPE
  - Webcasts
  - Hotlines

- For additional resources on internal control over financial reporting visit COSO at [http://www.coso.org/key.htm](http://www.coso.org/key.htm) or [www.cpa2biz.com](http://www.cpa2biz.com)

- The AICPA’s Audit Quality Centers offer specific guidance and resources
  - Governmental Audit Quality Center at [http://www.aicpa.org/gaqc](http://www.aicpa.org/gaqc)
  - Employ Benefit Plan Audit Quality Center at [http://www.aicpa.org/ebpaqc](http://www.aicpa.org/ebpaqc)
  - The Center for Audit Quality at [http://thecaq.aicpa.org](http://thecaq.aicpa.org)

- You can also visit [http://pcps.aicpa.org/Resources/PCPS+Practice+Management+Forums/](http://pcps.aicpa.org/Resources/PCPS+Practice+Management+Forums/) and download the recent webinar presented to AICPA PCPS members on "SAS No. 115 Amends and Replaces SAS No. 112"
I have read all the materials suggested and still have questions, who can I contact? Members may call the Accounting and Auditing Technical Hotline at 888-777-7077, menu option number 5, followed by menu option number 3. You may also submit questions to the online Accounting and Auditing Technical Hotline at http://www.aicpa.org/members/div/infohot/form.asp.

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