



Auditor Responsibilities and Documentation of
INTERNAL CONTROLS

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Internal Controls (per AU-C Sec 315)

- “A process effected by those charged with governance, management, and other personnel that is designed to provide *reasonable assurance* about the achievement of entity’s objectives with regard to:
 - Reliability of financial reporting
 - Effectiveness and Efficiency of operations
 - Compliance with applicable laws and regulations

Internal control over safeguarding of assets against unauthorized acquisition, use, or disposition may include controls relating to financial reporting and operations objectives.”



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Reporting Requirements

Type of Report	GAAS	GAGAS	Single Audit
Fair Presentation of Financial Statements	YES	YES	YES
Compliance and Internal Control over Financial Reporting		YES	YES
Compliance and Internal Control over Compliance for Federal Awards			YES
Fair Presentation of Schedule of Expenditures of Federal Awards			YES



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Obtaining an Understanding

- The auditor should obtain an understanding of internal control relevant to the audit.

AUC 315.13

- When obtaining an understanding of controls that are *relevant* to the audit, the auditor should evaluate the design of those controls and determine whether they have been implemented by performing procedures *in addition to inquiry of the entity's personnel*.

AUC 315.14



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Considerations Specific to Governmental Entities

- Governmental entity auditors often have *additional responsibilities* with respect to internal control.
- For example, to report on internal control over financial reporting and on internal control over compliance with law, regulation, and provisions of contracts or grant agreements, violations of which could have a direct effect on the determination of material amounts and disclosures in the financial statements.
- Governmental entity auditors also may have responsibilities to report on the compliance with law or regulation. **As a result, their review of internal control may be broader and more detailed.**

AU-C 315.A67



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Nature and Extent of Understanding Relevant Controls

- Evaluating the design of a control involves considering whether the control, *individually or in combination with other controls*, is capable of effectively preventing, or detecting and correcting, material misstatements.
- Implementation of a control means that the *control exists and that the entity is using it*.
- Assessing the implementation of a control that is not effectively designed is of little use, and so the design of a control is considered first.
- An improperly designed control may represent a significant deficiency or material weakness in the entity's internal control.

AU-C 315.A68



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Nature and Extent of Understanding Relevant Controls

- Risk assessment procedures to obtain audit evidence about the design and implementation of relevant controls may include:
 - inquiring of entity personnel.
 - observing the application of specific controls.
 - inspecting documents and reports.
 - tracing transactions through the information system relevant to financial reporting.
- Inquiry alone, however, is not sufficient for such purposes.

AU-C 315.A69



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Top Down Approach

- Using the top-down approach can improve audit effectiveness and efficiency in scoping the audit because it focuses on those controls related to relevant assertions for material accounts and significant classes of transactions.
- Gain an understanding of the overall risks of material misstatement at the financial statement level.
 - Identify the material accounts and classes of transactions that are significant to the financial statements and the relevant assertions related to those accounts.
 - For each relevant assertion identified, consider the risks of material misstatement, that is, what can go wrong.
 - Identify control objectives related to the assertion that addresses the risks.
 - Identify those controls (key controls) that mitigate the risks that the control objectives will not be achieved.



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Gaining an Understanding of Controls

- Minimum Requirements
 - Evaluate control design
 - Determine whether a control has been implemented
- Not required to gain an understanding of all controls – only those that are “relevant to the audit”
- Controls may relate to
 - Specific classes of transactions, account balances, and disclosures
 - More pervasively to the financial statements taken as a whole
- How?



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Documenting Activity-level Controls

- Flowcharts
- Narrative
- Control Point Worksheets
- Separation of Duties



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Flowcharting

- Depicts the auditor's understanding of the flows of a processing system (i.e. receipts, disbursements, payroll) from its origin to its end (general ledger).
- When preparing, trace direct flows of INFORMATION from the GL accounts back to their origins.
- Flowcharting tools—Excel or Word



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Steps to Prepare Flowchart

- Step 1: Documenting Accounts
- Step 2: Tracing the Flow of Accounting Information
- Step 3: Inserting Process and Document Symbols
- Step 4: Inserting Control Points
- Step 5: Source of Process Information



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Narrative

- Detail the operations step by step in chronological flow from origin of transaction through posting to general ledger
- Limited to essential processes
- Identify control points on the narrative and what processes they cover.



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Control Point Worksheet

- The objective is to identify the minimum number of controls that, if tested, can provide a basis for reliance.
- No processes!
- Most difficult to find a control at the boundary— but this area is the most important!
- The person performing the control should be different than the person performing the process.



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Process Vs Control

- Processes – procedures that **originate, transfer, or change** accounting data (examples: filling out an invoice, preparing a check, entering data into the GL). They can cause, generate or result in errors.
- Control - procedures designed to prevent or to detect and correct errors in a timely manner. Controls never generate errors but can lead to their correction (examples: bank reconciliations, budget to actual reviews).



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Walkthrough Documentation

- Auditor should record
 - Procedure or Control being Observed
 - Documents Examined
 - Walkthrough Procedures Performed
 - Person who Performs the Procedure or Control
 - Where & When Observation Occurred
 - Exceptions
 - Other Inquires or Comments



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Separation of Duties

- Identifies Three Functions:
 - Custody of or access to assets (e.g. cash, checks)
 - Access or *ability* to enter/modify information in the accounting records
 - Authorizing and/or reviewing transactions (approval)



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