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Article for *Minnesota Counties*

New Auditing Standards Will Impact the Conduct of Your Annual Audit

By Rebecca Otto, Minnesota State Auditor

In the last couple of years new auditing standards have been issued that could affect the nature, timing and extent of audit procedures performed by the auditor of your annual financial statements. One of the new standards, SAS 112, changes what and how results of the audit are reported. This new standard is effective in Minnesota, for audits of periods ending on or after December 15, 2006.

How does SAS 112 affect your county?

SAS 112 has more stringent reporting definitions that may have a significant impact on the number of findings and how those findings are reported. Your auditor must consider the “potential” magnitude of a control deficiency rather than the “known” magnitude. As a result, the number and type of written findings relating to internal controls may increase. In addition, the auditor will likely be required to gather more documentation and evidence to support those findings.

This standard, as well as other new auditing standards, will increase the emphasis placed on the need for adequate internal controls over financial reporting. This includes controls over the actual preparation of the annual financial statements, including disclosures.

SAS 112 has lowered the bar so that findings that may not have been previously reportable may now be considered reportable simply because there is the potential for misstatement. The SAS clarifies that the significance of a control deficiency is dependent on the potential for misstatement, not whether a misstatement actually occurred.

Also, the audit process may take longer because:

- 1) The auditor will be required to gather more evidence and documentation to evaluate whether or not findings are significant deficiencies or material weaknesses, and
- 2) The auditor must perform follow-up procedures on all previous audit findings.

What can your county do to prepare for SAS 112?

How your county considers the impact may depend on your size and complexity. However, preparing your county for the new SAS 112 environment should involve the following steps:

- **Educate yourself:** Learn the key components of strong internal controls, understand your financial statements and the required disclosures, and build a resource network to assist you as questions arise.
- **Eliminate all audits adjustments:** Talk to your auditor about the nature of any prior year audit adjustments, identify and record all potential adjustments prior to the audit, maintain a file of issues and/or transactions occurring during the year that might have generally accepted accounting principles (GAAP) accounting implications, seek advice from your auditor, or others, regarding these items prior to the audit, and consider the need to hire external assistance prior to the audit.
- **Educate your governing body:** Don't let your county board be blind-sided. Educate them so that they might assist in evaluating and improving controls.
- **Inventory your system:** Identify significant accounts, disclosures, processes and cycles that are used by, or take place in, your county.
- **Prioritize:** Do not try to fix or improve everything at once. Consider making improvements over multiple years. Identify the areas of greatest weakness and improve those first.

One of the best things you can do is to educate your staff, and in particular, your county board on SAS 112. Notify your county board now of the potential of more audit findings than the board may have seen in the past. You don't want to surprise the board at the meeting when the audit is presented.

We would also recommend reviewing internal controls over significant financial accounts or programs and answering the following questions:

- Are controls in place over the preparation of financial reports?
- Does documentation exist to support the activity of the financial account/program?
- Are duties adequately segregated?
- Are information technology controls over significant computer systems in place?
- Are controls in place to ensure routine reconciliations are performed?
- Are controls in place to adequately track and safeguard capital assets?
- Are controls in place to monitor subrecipients of federal grant funds?
- Is there adequate communication between the government's management, internal and external auditors, and the county board or audit committee?

As you are reviewing these controls, you should consider whether you know if the controls are effective. For example, are reviews and approvals evident? If the county has an internal audit department, does it test processes? Or is there another form of internal control monitoring? Have internal control findings been communicated previously? What steps have been taken to address prior internal control findings?

To further explain how this new auditing standard could affect the county, the Office of the State Auditor has prepared a comprehensive document, "What is 'SAS 112.'" This document is available on our web site under educational materials at <http://www.auditor.state.mn.us/default.aspx?page=educationalmaterials>