

# Wisconsin Department of Public Instruction, Financial Services Team WISCONSIN PUBLIC SCHOOL DISTRICT AUDIT MANUAL

## ***INTERNAL CONTROL***

### **AU-C Section 315 Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement**

Paragraph .04 of AU-C Section 315 defines internal control as “a process affected by those charged with governance, management, and other personnel that is designed to provide reasonable assurance about the achievement of the entity’s objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and 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.”

Internal controls consist of five interrelated components applicable to every organization (school district) regardless of size:

1. Control environment
2. Risk assessment
3. Information and Communication
4. Monitoring
5. Control Activities

The auditor should obtain an understanding of internal control relevant to the audit which is those control activities the auditor judges necessary to understand in order to assess the risks of material misstatement at the assertion level and design further audit procedures responsive to assessed risks. 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 when obtaining an understanding of controls that are relevant to the audit.

AU-C Section 315 Paragraph .21 states that “the auditor should also obtain an understanding of the process of reconciling detailed records to the general ledger for material account balances.” The auditor should document the understanding obtained.

### **Federal and State Compliance Audits**

***OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and OMB Circular A-133 Compliance Supplement, GAS A-133 Audit Guide, and SAS # 117***

Section 300(b) of OMB Circular A-133 requires recipients of federal awards to maintain internal control over federal programs to provide reasonable assurance that the awards are managed in compliance with laws, regulations, and provisions of contracts or grant agreements that could have a material effect on each program. When auditing under OMB Circular A-133, the auditor

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needs to not only be concerned with obtaining an understanding of internal control over the financial statements as a whole, but also the internal control pertaining to the compliance requirements for each major federal program.

OMB Circular A-133 requires additional consideration of internal control regardless of the assessed level of control risk. Section 500(c) of OMB Circular A-133 requires the auditor to gain an understanding, document, plan, and test internal control to support a low assessed level of control risk from major programs.

The OMB Circular A-133 Compliance Supplement, part 6, provides examples of internal control characteristics for each of the 14 compliance requirements by component (control environment, risk assessment, information and communication, monitoring, and control activities) to be used in planning and performing the audit.

Paragraph 9.09 of the GAS/A-133 AICPA Audit Guide explains that the “auditor should obtain an understanding of the five elements of internal control sufficient to assess the risks of material noncompliance with each direct and material compliance requirement for each major program.”

The GAS/A-133 AICPA Audit Guide at Paragraph 9.14 states that procedures used to evaluate the design of control over compliance and its implementation might include (a) inquiries of entity personnel, (b) inspection of documents and reports, and (c) observation of the application of the specific controls. Performing only inquiry is not sufficient for evaluating the design of a control and determining whether it has been implemented.

SAS No. 117 *Compliance Audits* requires auditors to document the risk assessment procedures performed including those related to gaining an understanding of internal control over compliance.

Testing of controls over compliance is required in an OMB Circular A-133 audit of compliance regardless of whether the auditor tests controls in the audit of the financial statements. OMB requires that the auditor perform testing of internal control for the assertions relevant to the major program compliance requirements. Accordingly, not all controls that may be relevant to the financial statements or the financial reporting system would need to be tested. When determining which controls to test, the auditor should do the following:

- Gain an understanding of the applicable compliance requirements for each of the major programs.
- Determine which compliance requirements have a direct and material effect on the major program.
- Determines the applicable controls for those compliance requirements.
- Determines what controls are in place to prevent or detect material noncompliance.

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- Documents and plans tests of those controls to support a low assessed level of control risk of noncompliance.