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STATEMENT ON AUDITING PROCEDURE

52

Reports on Internal Control Based on Criteria Established By Governmental Agencies

1. Following the issuance of Statement on Auditing Procedure No. 49, "Reports on Internal Control," some governmental agencies* have commenced or completed audit guides, questionnaires, or other publications that set forth criteria for evaluation of the adequacy for their purposes of internal control procedures of organizations with which they are concerned. Other agencies have been encouraged to do so in *Suggested Guidelines for the Structure and Content of Audit Guides Prepared by Federal Agencies for Use by CPAs*, which was issued in March 1972 by the Committee on Auditing for Federal Agencies of the American Institute of Certified Public Accountants. The purpose of this Statement is to supplement Statement on Auditing Procedure No. 49 by dealing more specifically with reports on internal control based on criteria established by agencies in reasonable detail and in terms susceptible to objective application. This Statement does not apply if such criteria have not been established.

* The concepts expressed in this Statement also apply to reports for other organizations, such as stock exchanges, that exercise regulatory, supervisory, or other public administrative functions.

*Issued by the Committee on Auditing Procedure
American Institute of Certified Public Accountants*

2. Such criteria may encompass specified aspects of internal accounting control, and may also encompass specified aspects of administrative control or of compliance with grants, regulations, or statutes. For this reason, the auditor's report should identify clearly the matters covered by his study. This can be accomplished by reference to the publication in which the established criteria are set forth. The report should also indicate whether the auditor's study included tests of compliance with the procedures covered by his study.

3. If criteria established by an agency are set forth in a questionnaire or other publication in reasonable detail and in terms susceptible to objective answers or application, the auditor's report may express a conclusion, based on the agency's criteria, concerning the adequacy of the procedures studied, with an exception as to any condition he believes is not in conformity with such criteria and is a material weakness. Upon request of the agency or at the auditor's discretion, his report may also refer to any condition he believes is not in conformity with the agency's criteria but is not a material weakness. When the auditor issues this form of report, he does not assume any responsibility for the comprehensiveness of the criteria established by the agency; however, he should report any relevant condition that comes to his attention in the course of his study that he believes to be a material weakness even though not covered by such criteria.

4. For the purpose of reports contemplated in paragraph 3, a material weakness means either (a) a condition in which the auditor believes the organization's prescribed procedures or the degree of compliance with them does not provide reasonable assurance that errors or irregularities in amounts that would be material in relation to the amount of the applicable grant or program would be prevented or detected within a timely period by employees in the normal course of performing their assigned functions, or (b) a condition in which the auditor believes the lack of conformity with the agency's criteria is material in accordance with any guidelines for determining materiality that are included in such criteria.

5. Reports that refer to weaknesses should describe such weaknesses in reasonable detail. The agencies ordinarily will require that such reports also include whatever comments are appropriate in the circumstances concerning any recommendations for corrective action.

6. When the auditor issues this form of report, he should also include a statement that it is intended for use in connection with the grant to which the report refers and that it should not be used for any other purpose.

The Statement entitled "Reports on Internal Control Based on Criteria Established by Governmental Agencies" was adopted by the assenting votes of twenty members of the Committee. Mr. Chapin dissented to the Statement.

Mr. Chapin dissents to the issuance of this Statement on the grounds that if a CPA is to express any conclusion as to the adequacy of procedures for a government agency's purposes, he ought to be required to be concerned with the appropriateness of the criteria by which adequacy is to be judged.

Since internal accounting control is clearly in the area of a CPA's professional expertise, Mr. Chapin believes that the CPA can design the criteria, or review and take responsibility for the appropriateness of the criteria, used to determine its adequacy for a government agency's purposes if those purposes are stated by the agency, and that the scope of the CPA's work ought to be expanded to enable him to assume this responsibility. With respect to administrative controls, he believes that the CPA should not express any conclusion concerning the adequacy of procedures for a government agency's purposes unless he determines that he is competent to, and does, perform such work as is necessary to enable him to form a judgment as to the appropriateness of the criteria by which adequacy is to be judged.

NOTE

Statements on Auditing Procedure present the considered opinion of the Committee on Auditing Procedure, which is the senior technical committee of the Institute designated to issue pronouncements on auditing matters. Departures from the Committee's recommendations must be justified by those who do not follow them.

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