

AU Section 9325

Communicating Internal Control Related Matters Identified in an Audit: Auditing Interpretations of Section 325

1. Communicating Deficiencies in Internal Control Over Compliance in an Office of Management and Budget (OMB) Circular A-133 Audit

.01 Question—AU section 325, *Communicating Internal Control Related Matters Identified in an Audit*, establishes standards and provides guidance on communicating matters related to an entity's internal control over financial reporting identified in an audit of financial statements. In an audit performed under Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Nonprofit Organizations* (also referred to as a single audit), the auditor also is responsible for reporting reportable conditions and material weaknesses in internal control over compliance as it relates to major programs. How should the definitions of the terms *control deficiency*, *significant deficiency*, and *material weakness*, found in AU section 325 be adapted and applied in the context of reporting on internal control over compliance in a single audit?

.02 Interpretation—The OMB has issued guidance on its Web site that amends Circular A-133 to address the applicability of AU section 325 to single audits. It indicates that for single audits of periods ending on or after December 15, 2006, the terms *reportable condition* and *material weakness*, as used in Circular A-133 when referring to internal control over compliance as it relates to major programs, should be replaced with the terms *significant deficiency* and *material weakness*, as defined in this Interpretation.

.03 Therefore, the following definitions should be used when an auditor reports on internal control over compliance in a single audit.¹ This change in terminology and the related definitions may result in the reporting of additional internal control over compliance matters than had been reported using the previous terminology and definitions.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect on a timely basis noncompliance with a type of compliance² requirement of a federal program.

¹ This Interpretation does not modify or replace an auditor's responsibility for communicating internal control over financial reporting matters under AU section 325, *Communicating Internal Control Related Matters Identified in an Audit*, or reporting such matters as required by Government Auditing Standards issued by the U.S. Government Accountability Office.

² This reference to "type of compliance requirement" refers to the first 13 types of compliance requirements (identified as A through M) described in Part 3 of the *OMB Circular A-133 Compliance Supplement* (the *Compliance Supplement*) and each individual special test and provision identified in Part 4 of the *Compliance Supplement* for each federal program. When a federal program is not included in the *Compliance Supplement*, the identification of types of compliance requirements that apply and are material to a federal program (including special tests and provisions) is made through a review of the program's contract and grant agreements and referenced laws and regulations.

A *significant deficiency*³ is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood⁴ that noncompliance with a type of compliance requirement⁵ of a federal program that is more than inconsequential⁶ will not be prevented or detected.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement⁷ of a federal program will not be prevented or detected.

.04 See also the AICPA Audit Guide Government Auditing Standards and *Circular A-133 Audits* for additional guidance on performing single audits.

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³ The term *significant deficiency* replaces the term *reportable condition* currently used in Circular A-133.

⁴ The term *remote likelihood* as used in the definitions of the terms *significant deficiency* and *material weakness* has the same meaning as the term *remote* as defined in the Financial Accounting Standards Board *Accounting Standards Codification* glossary. Therefore, the likelihood of an event is "more than remote" when it is at least reasonably possible. [Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

⁵ See footnote 2.

⁶ Noncompliance with a type of compliance requirement is inconsequential if a reasonable person would conclude, after considering the possibility of further undetected noncompliance, that the noncompliance, either individually or when aggregated with other noncompliance related to the same type of compliance requirement, would clearly be immaterial to a federal program. If a reasonable person would not reach such a conclusion regarding a particular noncompliance, that noncompliance is more than inconsequential.

⁷ See footnote 2.