

THE SARBANES-OXLEY SECTION 404 IMPLEMENTATION TOOLKIT

**PRACTICE AIDS FOR
MANAGERS AND AUDITORS**



**Includes
CD-ROM**

MICHAEL RAMOS

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**Practice Aids for Managers
and Auditors**

MICHAEL RAMOS



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About the Author

Michael Ramos was an auditor with KPMG and now works as an author and consultant. He is the author of *How to Comply with Sarbanes-Oxley Section 404: Assessing the Effectiveness of Internal Control*. This is his tenth book.

Preface

As I write this, companies are nearing the completion of their inaugural SOX 404 internal control assessment. For many, this process has been a struggle. I've met more than a few people who say they'll end up spending two years working to comply, their companies having spent untold millions of dollars. Soon, their work will be complete, and all involved will feel the lifting of a heavy weight from their shoulders as well as a great sense of professional pride. They'll take a much deserved rest.

And then . . .

It starts all over. Spring '05, SOX II. Then the next year and the year after, SOX III, SOX IV, like a string of Hollywood B movies. While all the attention has focused on first-year implementation, very few have had the time or desire to acknowledge that SOX 404 is with us now, a part of the way we do business.

The challenge in this first year has been compliance—understanding the ever-changing requirements and then committing all the resources necessary to get the job done. But now that you've made it through the first year, a new challenge awaits. Resources are finite. How do you now build on the process you created last year—cobbed together in response to the rapidly evolving rules—to create a methodology that is repeatable and able to be taught to and understood by someone who was not part of the core project team? What can you do to make the assessment of internal control more effective and less of a drain on already limited resources?

This book started out to be a collection of forms and checklists. It turned out to be something much different and, hopefully, more valuable. What I discovered was that creating this book was not about the forms; it's about the underlying process for SOX 404 compliance that the forms describe. Writing this book turned out to be an exercise in process engineering, not in form design. The critical questions asked during writing were always: "What should people do to comply?" "What's the best way for them to do that?" "How do the results of this work tie in to other parts of the process?" Once I figured out those questions, designing the checklist was fairly easy. All the practice aids in this book are just parts of a road map to lead you through a process that I've mapped out.

This process is still a bit fuzzy, but it is becoming increasingly more well-defined. Common approaches and methodologies have begun to emerge, which are reflected in these practice aids. A good starting point for understanding this process I've laid out is the first practice aid, the General Work Program (form ADM-1). All the other practice aids are just footnotes to this General Work Program, providing more structure and detail to the overall process. The practice aids are integrated to provide a consistency of approach for all the main phases in the internal control assessment: planning, documentation, testing, and reporting.

As I worked on this project and started to define what I thought was an effective and efficient process for SOX 404 compliance, I made some choices about the process that should be explained. First, at each phase of the project, the project team basically does two things:

1. They gather information, and then
2. They assess that information, pull it together to form a reasoned, supportable conclusion.

Most of these practice aids are designed to help in information gathering, and what I've tried to do is find ways to structure the presentations of that information so you can understand what it means.

Second, in the area of testing, I believe that the most successful SOX projects have been the ones where project teams have been actively engaged with operating personnel to discover “what really goes on” at the company. I've spoken with project team leaders and seen work programs that describe a testing approach that seems too hands-off to me. I'm concerned about the quality of the conclusions reached by a project team that relies primarily on a discussion with a single individual, or the reading of a document, or the observation that a code of conduct has been posted to the company intranet to draw conclusions about control design or operation. You'll see that the testing process I've laid out is much more involved and requires the project team to be more active—asking multiple questions, making observations, corroborating single instances of control compliance until a clear pattern emerges.

To use these practice aids as they were intended, I think it might also be helpful if I shared my basic principles for design. Over the years, I've worked with a number of certified public accountants (CPAs) who perform the same types of tasks required of a SOX 404 engagement. I've observed many, many instances where auditors have equated their *work* with the *documentation of the work*. If the subject matter of their tests is quantitative, this relationship holds true. For example, if an auditor is asked to test the accuracy of recorded interest expense, he or she would make a calculation of the expected expense (using average loan balance, the interest rate, etc.) and compare that expectation to the recorded amount. The auditor would then prepare a worksheet to show the calculation and the comparison. The process of doing the work—pushing around numbers to make a calculation—is the same as the documentation of the work.

This equality between work and work product is not true when dealing with subjective subject matters—such as internal control—where the primary tests are inquiry, observation, and analysis. Under these circumstances, if we put a checklist in front of someone, they too often believe their task is to complete the checklist. They focus their energy on filling out the checklist. This approach is misguided. The task is to gather and assess information and draw a supportable conclusion. The checklist is there to aid in their information gathering and assessment and to document conclusions. The checklist is only a means to an end, not an end in itself.

These practice aids are designed to be work product, a culmination of the work performed. To reinforce that idea, you'll see that the forms and checklists are addressed from the project team member to an audience of reviewers such as project team leaders, senior management, or the external auditors. They are designed to have the project team members “fill in the blank” about

- The work they performed
- What they observed, or the results of their tests
- What they concluded based on their observations or the results of the tests

By writing the forms in this fashion, I hoped to remind the project team member that completing the checklist is not the primary objective.

Preceding each form is a brief set of instructions on how to complete the form. These instructions are addressed from me to the project team. These instructions are not intended to be included in your final work product. These instructions provide reference to Securities and Exchange Commission (SEC) rules, Public Company Accounting Oversight

Board (PCAOB) standards, and other guidance, but they do not summarize or explain these requirements. These practice aids are intended to supplement the guidance you already have on SOX 404, and to the extent that questions arise about the information required to complete a form (e.g., “what is a material weakness?”), you should turn to those other sources of guidance.

Working on this book has forced me to clarify my own thoughts on what project teams should do to comply with SOX 404. By refining the 404 compliance process and creating this integrated tool set, I hope I have helped to make the process repeatable and therefore more efficient and effective. Postimplementation, this is the most immediate challenge we face.

Other challenges are still to come. These are for another day, perhaps another book. Enjoy!

Michael Ramos
October 2004

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THE SARBANES-OXLEY SECTION 404 IMPLEMENTATION TOOLKIT

PART I

Tools for Management

General Work Program

PURPOSE

This form has been designed to

- Facilitate the organization of an efficient process for evaluating the effectiveness of the company’s internal control
- Help ensure that the company’s assessment of internal control effectiveness contains all elements required by paragraph 40 of PCAOB Auditing Standard No. 2
- Facilitate an external auditor’s understanding and evaluation of the company management’s process for assessing the effectiveness of the company’s internal control over financial reporting

INSTRUCTIONS

Use this form to guide the design and performance of the company’s project to assess internal control effectiveness. As each step in the program is completed, the person responsible for performing that step should put his or her initials and the date in the indicated column on the worksheet. If the step is not applicable, indicate that by noting “N/A.” Use the “Notes” column to cross-reference to where the performance of the procedure is documented or to make other notations.

Notations in italics are additional instructions to the preparer of the form and should be removed before the form is considered final.

**ASSESSMENT OF INTERNAL CONTROL EFFECTIVENESS
GENERAL WORK PROGRAM**

Company: _____

Reporting Date: _____

Prepared by: _____

Date Prepared: _____

This form summarizes the procedures we performed to document, test, and report on the effectiveness of the company’s internal control over financial reporting.

Procedure Performed	N/A Performed by	Date	Notes
Project Planning			
1. Form the project team. Consider both internal and external resources and the expertise needed to successfully complete the project, including IT expertise. a. Determine the extent to which management intends to have the external auditors rely on the work of the project team in their audit of the company's internal control. For each project team involved with those areas i. Assess its competency. ii. Assess its objectivity.			
<i>[Consider using form ADM-2, Project Planning Summary, to document the performance of this step.]</i>			
2. Determine the nature of the internal control services, if any, that the company's external auditors will provide or have provided to the company during the current audit period. a. If the external auditors have provided internal control services to the company, obtain approval of the board and determine that this approval has been documented in the minutes.			
3. Gather current information relevant to the internal control assessment and make this available to the project team members to allow them to better plan the project.			

Procedure Performed	N/A Performed by	Date	Notes
<i>Determine Project Scope</i>			
<i>[For all steps listed in this subsection, related to project scope, consider using form ADM-2, Project Planning Summary, to document the performance of the step.]</i>			
<p>4. <i>Entity-level controls</i></p> <ul style="list-style-type: none"> a. Identify entity-level controls required to be documented, evaluated, and tested according to PCAOB, SEC, or other authoritative standards. b. Identify other entity-level controls designed to meet significant control objectives. 			
<p>5. <i>Centralized processing and controls</i></p> <ul style="list-style-type: none"> a. Identify all centralized processes and controls, including shared service environments, that affect the relevant assertions of significant accounts and disclosures. 			
<p>6. <i>Activity-level controls</i></p> <ul style="list-style-type: none"> a. Identify the significant accounts and disclosures within the financial statements. b. For all significant accounts identified in step 6a, identify the relevant assertions. c. For all significant accounts identified in step 6a, identify the major transactions affecting these accounts. Separately identify <ul style="list-style-type: none"> i. Routine transactions ii. Nonroutine transactions iii. Estimates 			

Procedure Performed	N/A Performed by	Date	Notes
<p>d. <i>Routine transactions</i>. For each routine transaction, identify the significant processing procedures.</p> <p>e. <i>Nonroutine transactions and estimates</i>. Determine that non-routine transactions identified in step 6c are included in the consideration of entity-level controls in step 4.</p>			
7. Determine the locations or business units to be included in the scope of the project.			
<p>8. Identify the significant processing procedures that are performed by third-party organizations.</p> <p>a. Determine which of the services performed by a third party are part of the company's information system.</p> <p>b. Determine how the project team will obtain the information necessary to understand and evaluate the design and operating effectiveness of controls at the third party (for example, by obtaining a Type 2 SAS No. 70 report).</p>			
<p>9. Consider how unusual circumstances will affect the scope of the project, including</p> <ul style="list-style-type: none"> • Business acquisitions made since the last internal control evaluation • Variable-interest entities (VIEs) included in the company's consolidated financial statements • Installation of a new accounting system 			

Procedure Performed	N/A Performed by	Date	Notes
10. Determine which business process owners will be required to provide subcertifications.			
<i>Project Administration</i>			
11. Prepare a timeline of the scheduled performance and completion of major project phases.			
12. Document significant planning decisions, for example by completing form ADM-2, Project Planning Summary.			
<i>Coordination with External Auditors—Project Planning</i>			
13. Communicate with the auditors, preferably in writing, to provide them with information that will help them plan their audit of internal control over financial reporting, including <ul style="list-style-type: none"> a. The extent of recent changes, if any, in the company, its operations, or its internal control b. Preliminary judgments about factors relating to the determination of material weaknesses c. Control deficiencies previously communicated to the audit committee or management d. Legal or regulatory matters of which the company is aware 			
14. In order to help the external auditors understand management's process for evaluating internal control effectiveness, consider providing the auditors with a copy of the documentation of significant planning matters prepared in step 12.			

Procedure Performed	N/A Performed by	Date	Notes
a. If you provide a copy of the documentation of significant planning matters, consider preparing a written request for consideration and feedback to clarify why management is providing the documentation to the auditors.			
<i>Documentation of Internal Control</i>			
15. <i>Documentation completeness.</i> For all locations, business segments, service organizations, or other units included within the project scope (see steps 7, 8, and 9), determine that the company has documented all significant controls relating to <ul style="list-style-type: none"> a. Entity-level controls identified in step 4 b. Centralized processes and controls identified in step 5 c. Activity-level controls identified in step 6 			
16. <i>Documentation currency.</i> Determine that the content of the internal control documentation is up to date and reflects current practices at the company. <ul style="list-style-type: none"> a. Identify all changes to internal control procedures since the documentation was last prepared. b. Determine that all changes to internal control procedures have been reflected in the documentation. c. Identify all changes to the internal control documentation since the last internal control audit and determine that the changes 			

Procedure Performed	N/A Performed by	Date	Notes
<ul style="list-style-type: none"> i. Were authorized ii. Are reflective of actual changes to control procedures 			
<p>17. <i>Documentation content.</i> Review the content elements of the documentation identified in step 15 to determine that it contains all necessary elements.</p> <ul style="list-style-type: none"> a. Entity-level and centralized controls should be described in sufficient detail to understand the nature of the control procedure and <ul style="list-style-type: none"> • Its relationship to control objectives • Who performs the procedure • How often it is performed • Whether and how performance of the procedure is documented • Other information necessary to assess the design effectiveness of the control b. Activity-level controls should include all items listed in step 17a plus <ul style="list-style-type: none"> • Information about how significant transactions are initiated, authorized, recorded, processed, and reported • Sufficient information about the flow of transactions to identify the points at which material misstatements due to error or fraud could occur 			
<p>18. Assess the efficiency and effectiveness of the company's processes for maintaining adequate documentation of internal control and recommend improvements, if applicable.</p>			

Procedure Performed	N/A Performed by	Date	Notes
<i>[If the company is considering the use of an integrated computerized software documentation solution, consider form DOC-4, Checklist for Evaluating SOX 404 Software.]</i>			
19. Confirm the design of internal control by performing procedures to understand how and how consistently the documented control procedures are performed by company personnel. For example, consider performing walkthrough procedures for the significant processes of major transactions.			
<i>[For suggestions on how to perform walkthrough procedures, see form TST-ACT-1.]</i>			
<i>Coordination with External Auditors—Documentation</i>			
20. If this is the first year the current external auditors will be performing an audit of the company's internal control, consider providing them with an example of the company's documentation of internal control. a. If you provide a copy of example documentation, consider preparing a written request for consideration and feedback to clarify why management is providing the documentation to the auditors.			

Procedure Performed	N/A Performed by	Date	Notes
<p>21. If the company uncovers inadequacies in its documentation of internal control, these inadequacies are considered control deficiencies that are required to be reported to the external auditors, even if corrected prior to year-end. Communicate these deficiencies to the auditors, preferably in writing, including a separate disclosure of all deficiencies believed to be significant deficiencies or material weaknesses.</p> <p>a. If material weaknesses in the documentation of the company's internal control are discovered, consider the need for disclosure in the company's interim SEC filings.</p>			
<p>22. In order to provide support for the company's assessment of internal control effectiveness in the future should such support be requested, prepare and archive a copy of the documentation of the company's internal control as it exists as of the end of the current fiscal year.</p>			
<p><i>Design Tests of Operating Effectiveness</i></p>			
<p><i>[The following steps should be performed for all entity-level, centralized and activity-level controls. Generally, entity-level and centralized control tests are performed before performing tests of activity-level controls.]</i></p>			
<p>23. Describe the parameters of the test, including</p> <p>a. The test objective</p> <p>b. Definition of deviations</p>			

Procedure Performed	N/A Performed by	Date	Notes
24. For each control identified in steps 4, 5, and 6, select the control procedures to be tested.			
25. Determine the nature of the tests to be performed, for example <ul style="list-style-type: none"> • Inquiries or written surveys of company personnel • Inspection of documentation of control performance • Observations of control performance • Reperformance of controls 			
26. Determine the point in time at which the controls will be tested.			
27. Determine the period of time to be covered by the tests.			
28. Determine the extent of the tests to be performed. For example <ul style="list-style-type: none"> • If inquiries or surveys are to be made of company personnel, how many and which individuals will be chosen to participate? • If the control procedure is to be observed or reperformed, how many times? • If documentation is to be inspected, which ones? 			
29. If the company receives a Type 2 SAS No. 70 report from one or more third-party organizations that are part of the company's information system, review these report(s) and evaluate their findings.			
<i>Consider using forms TST-ACT-3 and TST-ACT-3a to help you review a Type 2 SAS No. 70 report.</i>			

Procedure Performed	N/A Performed by	Date	Notes
30. If sampling techniques are to be used to select items to be tested, develop a sampling plan that addresses <ul style="list-style-type: none"> a. The population from which the sample will be drawn b. The sample size c. Sample selection methodology 			
31. Schedule the timing of the tests, for example, <ul style="list-style-type: none"> • Determine which controls will be tested first and the sequencing of the tests to follow. 			
<i>[Note: Generally, entity-level and common controls are tested prior to testing activity-level controls.]</i>			
<ul style="list-style-type: none"> • Make any necessary arrangements to coordinate with company personnel or project team members included in the testing. 			
<i>Coordination with External Auditors—Test Design</i>			
32. Consider providing the external auditors with a summary of the nature, timing, and extent of planned tests of control operating effectiveness. <ul style="list-style-type: none"> a. If you provide a summary of the planned tests of controls, consider preparing a written request for consideration and feedback to clarify why management is providing the summary to the auditors. 			
<i>Perform and Document Tests</i>			
33. Perform the tests designed in steps 23–32.			

Procedure Performed	N/A Performed by	Date	Notes
34. Prepare documentation of the tests performed and their results.			
35. Identify testing exceptions and determine whether they indicate the existence of one or more control deficiencies. a. If a determination is reached that a testing exception did <i>not</i> indicate a control deficiency i. Perform and document additional procedures. ii. Document the reasons for concluding that the testing exception was <i>not</i> considered to be a sign of a control deficiency.			
36. Obtain and review subcertifications from selected business process owners.			
37. For identified control deficiencies, develop a plan and take remedial action to correct the deficiencies.			
38. Disclose to the external auditors all deficiencies in internal control, including separately disclosing all deficiencies determined to be significant deficiencies or material weaknesses. a. If material weaknesses in the company's internal control are discovered, consider the need for disclosure in the company's interim SEC filings.			
<i>Evaluate and Report</i>			
39. Assess the need to update tests of controls performed in advance of year-end. If necessary, update tests.			

Procedure Performed	N/A Performed by	Date	Notes
40. For controls implemented since the testing date, including newly designed controls to remediate control deficiencies, <ul style="list-style-type: none"> a. Review the documentation of the control and assess its adequacy. b. Test the operating effectiveness of the control as of year-end (See steps 23–38). 			
41. Summarize and evaluate results of the tests.			
42. Prepare management's report on internal control effectiveness.			
43. Consider the need for other internal control–related disclosures in SEC filings.			
44. Determine whether there was any material fraud or any other fraud that, although not material, involved senior management or management or other employees who have a significant role in the company's internal control.			
45. Summarize all significant deficiencies and material weaknesses reported by the external auditors to company management as part of previous audits of internal control. Identify how each of these deficiencies was, or was not, corrected.			

Procedure Performed	N/A Performed by	Date	Notes
<p>46. Determine whether, subsequent to the date being reported on, there were any changes in internal control or other factors that might significantly affect internal control, including any corrective action taken with regard to significant deficiencies and material weaknesses. Consider</p> <ul style="list-style-type: none"> • Relevant internal audit reports issued during the subsequent period • External auditor reports of significant deficiencies or material weaknesses • Regulatory agency reports on the company's internal control • Information about the effectiveness of the company's internal control obtained from other sources 			
<p>47. Prepare a written representation letter for the external auditors that conforms to the requirements of PCAOB Auditing Standard No. 2.</p>			
<p><i>[See COM-2, Example Management Representation Letter.]</i></p>			

Project Planning Summary

PURPOSE

This form has been designed to

- Help make important decisions in planning management’s project for testing the effectiveness of the company’s internal control
- Document key planning decisions and the basis for those decisions

INSTRUCTIONS

Use this form to guide the planning of the company’s project to assess internal control effectiveness. The completed form can be circulated to project team members, business process owners, external auditors, and others involved in the project. The form is divided into the following six sections.

- Project Team Members and Responsibilities
- Project Team Members’ Competence and Objectivity
- Internal Control Information Sources
- Project Scope
- Internal Control Documentation Sources
- Project Schedule

Each section of the form includes an introduction that describes its purpose and content. These introductions have been written from the *project manager’s* point of view, so they should be read carefully and modified by the project manager, as appropriate.

Included as appendixes to the form are the decision aids to help you make and document key planning decisions. Attach the completed aids (to the extent that you use them) to the final planning document.

Footnoted comments in italics are additional instructions to the preparer of the form and should be removed before the form is considered final.

**ASSESSMENT OF INTERNAL CONTROL
EFFECTIVENESS PROJECT PLANNING**

Company: _____

Reporting Date: _____

Prepared by: _____

Date Prepared: _____

This form summarizes the most significant decisions made about our planning of the company’s process for evaluating the effectiveness of its internal control and our support for making these decisions. This form has been prepared to

- Assist the company’s independent auditors in their understanding and evaluation of our process
- Communicate the project plan to project team members
- Establish a concise, permanent record of the significant facts and circumstances that influenced the design of our project and the company’s compliance with the requirements to review the effectiveness of internal control

PROJECT TEAM MEMBERS AND RESPONSIBILITIES

Company management is responsible for evaluating the effectiveness of internal control and presenting a written assessment of that assessment as of the end of the fiscal year. Our chief executive officer and chief financial officer bear the ultimate responsibility for the planning and performance of our project to assess internal control effectiveness.

To carry out the day-to-day performance and administration of the project, we formed a project team, which reports directly to those individuals responsible for management’s report on internal control effectiveness. To form our project team, we considered the need for individuals both internal and external to the company that possessed the following:

- Knowledge of company business processes and operations
- Knowledge of company control policies and procedures
- Expertise in information technology systems and controls
- Knowledge of financial accounting and reporting matters, including SEC reporting requirements
- Expertise in the design, documentation, testing, and evaluation of internal control

The following table summarizes key project team members.

Project Team	Name(s)	Internal/ External	Summary of Responsibilities
Management			
Chief executive officer (CEO)		Internal	With CFO, shares ultimate responsibility for the assessment of internal control effectiveness
Chief financial officer (CFO)		Internal	With CEO, shares ultimate responsibility for the assessment of internal control effectiveness

Project Team	Name(s)	Internal/ External	Summary of Responsibilities
Overall project manager		Internal	Day-to-day planning and project performance
Individual Project Teams ¹			
Technical Specialists ²			

¹ For example, “documentation,” “testing,” etc. The individual teams described in this section will vary according to how your project is organized. The three rows indicated here are for example purposes only and should not be construed to limit the number of your individual project teams.

² For example, “information technology.” Your project may include more than the two specialists suggested by this example form.

PROJECT TEAM MEMBERS’ COMPETENCE AND OBJECTIVITY

As part of their audit of the company’s internal control, the company’s external auditors may rely on certain tests of controls performed by project team members. The following summarizes the project team members and the control areas that may meet the criteria described in paragraphs 108–126 of PCAOB Auditing Standard No. 2, allowing the external auditors to rely on their work. The third column indicates where information on the project team’s competence and objectivity can be located.

Project Team Member	Control Area(s) Tested	Ref. to Information on Competence and Objectivity¹

¹ Consider attaching form ADM-2a, *Checklist for Summarizing Project Team Competence and Objectivity*, for each project team listed.

INTERNAL CONTROL INFORMATION SOURCES

The project gathered and reviewed the following relevant, current information about the company's operations, financial reporting, and internal controls for the purpose of helping plan the project.

Description	Reviewed	Reference
Recent SEC filings, including the most recent 10-K and all 10-Qs subsequently filed	Y N	
Documentation of tests performed in previous assessments of internal control effectiveness	Y N	
Previously identified testing exceptions or control deficiencies	Y N	
Current efforts to remediate previously identified control deficiencies	Y N	
Internal control reports of the company's internal auditors	Y N	
Communications from the company's external auditors on internal control matters	Y N	
Guidance on internal control assessment or reporting from the PCAOB or SEC that has been issued since the previous assessment project	Y N	
Relevant findings or recommendations of the disclosure committee	Y N	

PROJECT SCOPE

This section summarizes the factors considered and decisions made regarding the controls that were included in the scope of our project. These decisions were made for the areas indicated below.

	Yes	N/A
Entity-level controls	<input type="checkbox"/>	<input type="checkbox"/>
Activity-level controls	<input type="checkbox"/>	<input type="checkbox"/>
Multiple business units or locations	<input type="checkbox"/>	<input type="checkbox"/>
Controls at service organizations	<input type="checkbox"/>	<input type="checkbox"/>
Other considerations		
Describe _____	<input type="checkbox"/>	<input type="checkbox"/>

Entity-Level Controls

PCAOB Auditing Standard No. 2 provides definitive guidance on the entity-level controls required to be included in the scope of our internal control assessment. Our project was designed to comply with these requirements and accordingly, the scope of the project included the following.

	Yes	N/A
Control environment	<input type="checkbox"/>	<input type="checkbox"/>
Management's risk assessment process	<input type="checkbox"/>	<input type="checkbox"/>
Controls to monitor other controls	<input type="checkbox"/>	<input type="checkbox"/>
Period-end financial reporting process	<input type="checkbox"/>	<input type="checkbox"/>
Selection and application of accounting policies	<input type="checkbox"/>	<input type="checkbox"/>
Board-approved policies that address significant business control and risk management practices	<input type="checkbox"/>	<input type="checkbox"/>
Audit committee effectiveness	<input type="checkbox"/>	<input type="checkbox"/>
Antifraud programs and controls	<input type="checkbox"/>	<input type="checkbox"/>
Information technology general controls	<input type="checkbox"/>	<input type="checkbox"/>
Controls on which other controls are dependent	<input type="checkbox"/>	<input type="checkbox"/>
Controls over significant nonroutine and nonsystematic transactions	<input type="checkbox"/>	<input type="checkbox"/>

In addition to the preceding entity-level controls, our project included the documentation, testing, and evaluation of the following entity-level controls:

Centralized Processes and Activity-Level Controls

To determine the common processes and activity-level controls included within the scope of the project, we performed the following three steps:

- 1. Identified the significant financial statement accounts or account groups
- 2. Identified significant financial statement disclosures
- 3. Identified the major transactions/business processes for each significant financial statement account and disclosure

SIGNIFICANT ACCOUNTS AND DISCLOSURES

A listing of the significant financial statement accounts and disclosures is included as attachment ■■ to this form. *[Attach a list of significant financial statement accounts and disclosures. Alternatively, you may wish to complete and attach form ADM-2b.1, Worksheet for Determining and Documenting Significant Accounts and Disclosures.]*

MAJOR TRANSACTIONS/BUSINESS PROCESSES

PCAOB Auditing Standard No. 2 requires us to include within the scope of our project the major “transactions” for each significant account and disclosure. We use the term “transactions” interchangeably with “business processes.” We consider “major” business processes to be those that are significant to the company’s financial statements.

The documentation, testing, and evaluation of company activity-level controls are organized according to the significant processes relating to major business processes. Included as attachment ■ to this form is a list of major business processes. *[Alternatively, you may wish to complete and attach form ADM-2b.2, Mapping of Business Processes to Significant Accounts and Disclosures.]*

Consideration of Multiple Business Units or Locations

Appendix B of PCAOB Auditing Standard No. 2 and the answers to Q16–Q18 in the PCAOB Staff Questions and Answers (dated June 23, 2004) provide guidance to auditors on the consideration of multiple business units or locations. Although this guidance applies most directly to external auditors, we adapted and applied it in determining the business units or locations to be included within the scope of our project.

The table on the following page is a summary of all the business units or locations of the company and an indication of which were included within the scope of our project.

Business Unit	Financial Summary (in Thousands of Dollars)			Financially Significant?	Specific Risks	Nature of Risk	Significant in Aggregate	Excluded from Project
	Revenues	Net Income	Assets					
Consolidated Financial Statements	\$	\$	\$					
Business Unit #1	\$	\$	\$					
Business Unit #2	\$	\$	\$					
Business Unit #3	\$	\$	\$					
Business Unit #4	\$	\$	\$					
Business Unit #5	\$	\$	\$					

INSTRUCTIONS FOR COMPLETING THE SUMMARY

- List each business unit or location in the first column of the worksheet.
- Financial summary. Provide a summary (in dollars) of the operations and financial position of the company at the consolidated level and for each business unit. This information will be helpful in supporting conclusions about which business units have been included within the scope of the project.
- Using the guidance provided in paragraph B1 of PCAOB Auditing Standard No. 2, determine which business units are financially significant, and indicate this conclusion by marking an X in the “Financially Significant” column.
- Using the guidance provided in paragraph B6 of PCAOB Auditing Statement No. 2 and Q16 of PCAOB Staff Questions and Answers (June 23, 2004), determine which business units contain specific risks. Indicate this conclusion by marking an X in the “Specific Risks” column. Summarize the risk in the “Nature of Risk” column.
- Using the guidance provided in paragraph B2 of PCAOB Auditing Standard No. 2, determine which business units, when aggregated, represent a group with a level of financial significance that could create a material misstatement in the financial statements.
- All remaining business units are excluded from the scope of the project. Identify these business units by marking an X in the column “Excluded from Project.”
- Review the completed summary and determine that the scope of the project includes testing a “large portion” of the company’s operations and financial condition. Consider the guidance provided in paragraph A17 of the PCAOB Staff Questions and Answers (June 23, 2004) to make this determination.

COMPANY-LEVEL CONTROLS FOR BUSINESS UNITS THAT ARE SIGNIFICANT ONLY WHEN AGGREGATED WITH OTHER BUSINESS UNITS

We documented, placed in operation, tested, and evaluated the operating effectiveness of all company-level controls over individually unimportant locations and business units that, when aggregated with other locations or business units, might have a high level of financial significance. Those controls, together with a reference to the related testwork, are summarized as follows.

Description of Relevant Company-Level Control	Reference

OTHER CONSIDERATIONS

In choosing which business units and locations to include within the scope of our project, we encountered certain conditions not summarized in the preceding section. Those conditions and how they affected our decisions relating to project scope are summarized as follows.

CONCLUSION

We believe that our selection of the business units indicated in the preceding summary results in our testing a large portion of the company’s operations and financial position.

Consideration of Controls at Service Organizations

The company uses one or more service organizations to process certain of its transactions. For those service organizations that we determined were part of the company’s information system we

- Obtained an understanding of the controls at the service organization that are relevant to our company’s internal control
- Obtained an understanding of the controls maintained by the company over the activities of the service organization
- Obtained evidence that the controls (both at the service organization and at the company) that are relevant to our assessment of internal control effectiveness are operating effectively

The following table summarizes the service organizations whose services are considered part of the company’s information system, together with our overall approach to how we included them within the scope of our engagement.

SUMMARY OF APPROACH TO SERVICE ORGANIZATIONS

Service Organization	Testing Approach			SAS 70 Type II Report	Reference
	Services Provided	Company Controls	Service Organization Controls		

INSTRUCTIONS FOR COMPLETING THE TABLE

- Determine which of the service organizations used by the company provide services (i.e., process major transactions) that are part of the company’s information system.

- Summarize the organization and the service(s) they provide in the first two columns of the table.
- Determine which of the testing approaches the company will use to obtain information about the design and operating effectiveness of the controls related to major transactions that are processed by a service organization. Place an X in each column that applies.
 - “Company Controls” indicates that you will document, test, and evaluate the company’s controls over the activities of the service organization.
 - “Service Organization Controls” indicates that you will test the controls at the service organization.
 - “SAS 70 Type II Report” indicates that you will obtain and review a service auditor’s report on controls placed in operation and tests of operating effectiveness.
 - Provide a reference to where the relevant documentation and the results of tests of operating effectiveness can be found.

INTERNAL CONTROL DOCUMENTATION SOURCES

[This section of the Planning Summary may be helpful to project team members and the external auditors by allowing them to understand the scope and relative magnitude of the documentation of internal control and how that documentation can be accessed.]

Entity-Level Controls

The following table summarizes the entity-level controls included within the project scope and where the documentation related to the design of these controls can be found.

INSTRUCTIONS FOR COMPLETING

- Identify the documents the company maintains relating to entity-level controls. Examples might include the following:
 - Code of conduct
 - Board of directors or audit committee charter
 - Human resources policies relating to the recruiting, hiring, training, compensation, promotion, or termination of employees
 - Organizational chart
- List the title of these documents across the horizontal axis.
- For each document, determine which entity-level control(s) the document addresses. Put an X in the appropriate cell.

	Where to Find Documentation of Control Design						
	Corporate Governance Documents			Human Resources Policies	Information Technology Documents	Type 2 SAS 70	Other
Entity-Level Controls							
Control environment							
Management's risk assessment process							
Controls to monitor other controls							
Period-end financial reporting process							
Board-approved policies that address significant business control and risk management practices							
Audit committee effectiveness							
Antifraud programs and controls							
Information technology general controls							
Controls on which other controls are dependent							
Controls over significant nonroutine and nonsystematic transactions							
Other entity-level controls							

Documentation of Internal Control Policies and Procedures

The company’s documentation of its major business processes and related activity-level controls is maintained and can be accessed as follows.

INSTRUCTIONS FOR COMPLETING THIS SECTION

Summarize the methods and the technology used to prepare, maintain, and store the company’s documentation of internal control. For example, if the company uses an automated software solution for the documentation of internal control, provide pertinent information related to that solution in this section of the form.

PROJECT SCHEDULE

[It will be helpful to all those involved in the project if you include a proposed project schedule in your Planning Summary. The following is just one example of how such a summary might be prepared. Note that the first column should contain all the entity- and activity-level controls previously identified as being included within the scope of the project. The schedule should indicate the timing of the major phases of the project, such as review of documentation, testing, and evaluation.]

Legend	
Review documentation	<div></div>
Test effectiveness	<div></div>
Evaluate and/or report	<div></div>

[illegible]

Checklist for Summarizing Project Team Competence and Objectivity

PURPOSE

This form has been designed to

- Summarize your evaluation of the competence and objectivity of the individuals performing tests of controls, for the primary purpose of supporting the external auditor’s decisions about using these tests in their audit of internal control

INSTRUCTIONS

In the spaces provided along the horizontal axis, insert the names of the individuals who will be testing controls, together with the areas to which they have been assigned. This information should correspond to the information entered into “Project Team Members’ Competence and Objectivity” in form ADM-2, Project Planning Summary.

For each testing team member, answer the questions listed in the first column. For additional guidance on these questions, please refer to paragraphs 117–120 of PCAOB Auditing Standard No. 2.

To support your answers to questions relating to educational level, professional experience, and continuing education, consider attaching relevant documentation, such as resumes of the project team members.

Provide an explanation of any “No” responses.

Footnoted comments in italics are additional instructions to the preparer of the form and should be removed before the form is considered final.

ASSESSMENT OF INTERNAL CONTROL EFFECTIVENESS PROJECT TEAM COMPETENCE AND OBJECTIVITY

Company: _____

Reporting Date: _____

Prepared by: _____

Date Prepared: _____

This form summarizes our pertinent information related to the competence and objectivity of individuals who performed tests of controls.

[illegible]

Objectivity										
	Individual #1		Individual #2		Individual #3		Individual #4		Individual #5	
	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
<p>Is the individual prohibited from testing controls in the following areas?</p> <ul style="list-style-type: none"> • Areas in which relatives are employed in important or internal control–sensitive positions • Areas to which the individual was recently assigned • Areas to which the individual is scheduled to be assigned upon completion of control testing responsibilities 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<p>If the individual is responsible for the work of others who test controls</p> <ul style="list-style-type: none"> • Does the individual report to an officer of sufficient status within the company? • Does the individual have direct access and report regularly to the board of directors or audit committee? • Does the board of directors or audit committee oversee decisions related to the individual's employment? 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Worksheet for Determining and Documenting Significant Accounts and Disclosures

PURPOSE

This form has been designed to

- Aid in the determination of which financial statement accounts and disclosures are considered significant
- Provide documentation related to project scope considerations for common processing and activity-level controls

INSTRUCTIONS

First, determine whether this form is necessary. Based on your knowledge of the company and your previous experience, you may determine that all or almost all of the company's financial statement accounts are considered significant. If so, then you should consider documenting that fact, together with a list of those accounts *not* included in the project scope, along with an explanation for why these accounts are not considered significant.

The following discussion describes how the form should be completed, in the event that you determine it would be helpful for your project.

The horizontal axis of this matrix is an application of the guidance for identifying significant accounts contained in paragraphs 61, 64–65, and 67 of PCAOB Auditing Standard No. 2. Paragraph 65 of the standard lists several factors that should be considered when determining whether an account is significant. These factors are presented in the first column of the following table, together with an interpretation of how the factors might be considered.

Guidance Included in the Auditing Standard	How the Factor Might Be Considered	
	Indicates <i>More Significant</i>	Indicates <i>Less Significant</i>
Size and composition of the account	Large balance	Small balance
Susceptibility of loss due to errors or fraud	Highly susceptible	Less susceptible

	How the Factor Might Be Considered	
Guidance Included in the Auditing Standard	Indicates <i>More Significant</i>	Indicates <i>Less Significant</i>
Volume of activity, complexity, and homogeneity of the individual transactions processed through the account	Large volume, complex transactions, great variety of transactions included in the account	Small volume, simple, homogeneous transactions
Nature of the account (for example, suspense accounts generally warrant greater attention)	To be determined based on your judgment	To be determined based on your judgment
Accounting and reporting complexities associated with the account	Complex accounting and reporting	Relatively simple accounting and reporting
Exposure to losses represented by the account (for example, loss accruals related to a consolidated construction contracting subsidiary)	Significant exposure to loss	Minimal exposure to loss
Likelihood (or possibility) of significant contingent liabilities arising from the activities represented by the account	Greater than remote possibility of significant contingent loss	Remote possibility of significant contingent loss
Existence of related-party transactions in the account	Related-party transactions included in account	No related-party transactions included in account
Changes from the prior period in account characteristics (for example, new complexities or subjectivity or new types of transactions)	Substantial changes from prior period	Minimal changes from prior period

The vertical axis lists the account groups and selected individual accounts reported in the company's financial statements. *The listing in the attached example is for illustrative purposes only and should be modified for your company's unique circumstances.*

For each account group or account, assess the factor listed in the column heading and determine whether it poses a high, medium, or low risk of material misstatement. Once all factors have been considered, determine whether the account is considered significant, based on the assessed risks of material misstatement.

Footnoted comments in italics are additional instructions to the preparer of the form and should be removed before the form is considered final.

ASSESSMENT OF INTERNAL CONTROL EFFECTIVENESS SIGNIFICANT ACCOUNTS AND DISCLOSURES

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

This matrix documents the accounts we identified as significant and therefore included within the scope of its assessment of internal control effectiveness.

The risk assessment criteria across the horizontal axis are defined in PCAOB Auditing Standard No. 2 as

- *Size and composition.* Size and composition of the account.
- *Exposure to loss.* Susceptibility of loss due to errors or fraud; exposure to losses represented by the account (e.g., loss accruals related to a consolidated construction contracting subsidiary).
- *Transactions.* Volume of activity, complexity, and homogeneity of the individual transactions processed through the account.
- *Complexity.* Accounting and reporting complexities associated with the account.
- *Contingent liability.* Likelihood (or possibility) of significant contingent liabilities arising from the activities represented by the account.
- *Related party.* Existence of related-party transactions in the account.
- *Changes from prior period.* Changes from the prior period in account characteristics (e.g., new complexities or subjectivity or new types of transactions).
- *Other.* Any other factor, including the nature of the account (e.g., suspense accounts generally warrant greater attention).

Risks were assessed as

- *High.* The risk of material misstatement caused by the factor is probable.
- *Moderate.* The risk of material misstatement caused by the factor is reasonably possible.
- *Low.* The risk of material misstatement caused by the factor is remote.

Overall, we considered an account to be significant if there is more than a remote likelihood that the account could contain misstatements that individually, or when aggregated with others, could have a material effect on the financial statements, considering the risks of both overstatement and understatement.

	Risk Assessment Criteria								
Account Group/ Subgroups	Size and Composition	Exposure to Loss or Liability	Transactions	Complexity	Contingent Liabilities	Related Party	Change from Prior Period	Other	Significant Account?
Cash									
Accounts receivable									
Investments Trading Available for sale Held-to- maturity									
Inventory Raw materials Work in process Finished goods									
Property, plant, and equipment									
Goodwill and intangible assets									
Prepaid expenses and other assets									

	Risk Assessment Criteria								
Account Group/ Subgroups	Size and Composition	Exposure to Loss or Liability	Transactions	Complexity	Contingent Liabilities	Related Party	Change from Prior Period	Other	Significant Account?
Accounts payable									
Accrued liabilities									
Minority interest									
Other current liabilities									
Long-term debt Current Noncurrent									
Deferred taxes Current Noncurrent									
Subordinated debt									
Stockholders' equity Common stock Preferred stock Paid-in-capital Retained earnings Other comprehensive income									

	Risk Assessment Criteria								
Account Group/ Subgroups	Size and Composition	Exposure to Loss or Liability	Transactions	Complexity	Contingent Liabilities	Related Party	Change from Prior Period	Other	Significant Account?
Revenues									
Cost of sales									
Personnel costs									
Occupancy costs									
Selling costs									
Administrative expenses									
Income taxes									

Mapping of Business Processes to Significant Accounts and Disclosures

PURPOSE

This form has been designed to help you

- Identify the major transactions associated with each significant account and disclosure
- Organize the overall approach to the project

INSTRUCTIONS

Paragraph 72 of PCAOB Auditing Standard No. 2 identifies the following three types of transaction:

- *Routine transactions* are recurring financial activities reflected in the accounting records in the normal course of business (e.g., sales, purchases, cash receipts, cash disbursements, payroll).
- *Nonroutine transactions* are activities that occur only periodically (e.g., taking physical inventory, calculating depreciation expense, adjusting for foreign currencies). A distinguishing feature of nonroutine transactions is that data involved generally are not part of the daily flow of transactions.
- *Estimation transactions* are activities that involve management judgments or assumptions in formulating account balances in the absence of a precise means of measurement (e.g., determining the allowance for doubtful accounts, establishing warranty reserves, assessing assets for impairment).

When completing the attached matrix, *you should consider only routine transactions*. Controls related to nonroutine transactions and estimates are considered as part of the documentation, testing, and evaluation of entity-level controls. Similarly, the period-end financial reporting process also is considered as part of the evaluation of entity-level controls.

The horizontal axis of the matrix lists all significant accounts and disclosures you previously identified as being significant to the financial statements and, therefore, included within the scope of the project. *The listing in the example is for illustrative purposes only and should be modified for your company's unique circumstances.*

The vertical axis lists the company's major transactions. Included as an appendix to this form is a list of example routine business processes/major transactions that provides

more detail on the nature of the transactions listed in the matrix. *The listing in the example is for illustrative purposes only and should be modified for your company's unique circumstances.*

The company's internal control and your project teams are most likely to be organized according to major transactions and the related processes, rather than by financial statement account title. For example, one project team would be responsible for assessing controls related to cash disbursements for *all* accounts.

Completing the matrix is a two-step process.

1. Review each major transaction. Determine which financial statement account(s) the transaction affects. Place an X in the corresponding cell(s).
2. Each financial statement account may be affected by more than one transaction. For example, cash accounts are affected by both cash receipts and cash disbursements. Once you have completed the matrix, review each significant account (column). Determine that all *routine* debits and credits to the account have been encompassed in the identified business processes. If some routine debits and credits have not been included, you will need to add a new business process to the vertical axis. Once you have determined that all routine debits and credits to the account have been included in the scope of the project, indicate this conclusion by signing off in the first row of the matrix.

Footnoted comments in italics are additional instructions to the preparer of the form and should be removed before the form is considered final.

**ASSESSMENT OF INTERNAL CONTROL EFFECTIVENESS
MAPPING OF BUSINESS PROCESSES TO SIGNIFICANT
ACCOUNTS AND DISCLOSURES**

Company: _____

Reporting Date: _____

Prepared by: _____

Date Prepared: _____

ASSETS

Business Process	Cash	Accounts Receivable	Investments	Inventory	Property, Plant, and Equipment	Goodwill and Intangibles	Prepays and Other
Manage logistics and receive inventory							
Process product costs							
Process and ship customer orders							
Process accounts receivable							
Authorize purchases							
Process accounts payable							
Cash receipts							
Cash disbursements							
Safeguard assets							
Process investment transactions							
Process finance transactions							
Record fixed assets activity							
Safeguard assets							
Process payroll							

LIABILITIES AND EQUITY

Business Processes	Accounts Payable	Accrued Liabilities	Minority Interest	Other Current Liabilities	Long-term Debt	Deferred Taxes	Equity
Manage logistics and receive inventory							
Process product costs							
Process and ship customer orders							
Process accounts receivable							
Authorize purchases							
Process accounts payable							
Cash receipts							
Cash disbursements							
Safeguard assets							
Process investment transactions							
Process finance transactions							
Record fixed assets activity							
Safeguard assets							
Process payroll							

REVENUES AND EXPENSES

Business Processes	Revenues	Cost of Sales	Personnel Costs	Occupancy Costs	Selling Costs	Administrative Expenses	Income Taxes
Manage logistics and receive inventory							
Process product costs							
Process and ship customer orders							
Process accounts receivable							
Authorize purchases							
Process accounts payable							
Cash receipts							
Cash disbursements							
Safeguard assets							
Process investment transactions							
Process finance transactions							
Record fixed assets activity							
Safeguard assets							
Process payroll							

APPENDIX: EXAMPLE ROUTINE BUSINESS PROCESSES/MAJOR TRANSACTIONS

The following table summarizes example routine business processes for a generic business, which have been adapted from the COSO Internal Control Integrated Framework.

Note that these are examples of *routine* transactions and business practices that are considered when testing activity-level controls. These examples do *not* include the following, which are tested as part of the entity-level tests.

- Nonroutine transactions, which occur only periodically
- Accounting estimates, which involve management judgments or assumptions in formulating account balances in the absence of a precise means of measurement
- Activities related to the period-end financial reporting process, including the preparation of the financial statements and financial statement disclosures

Example Routine Business Processes/Major Transactions	
Summary	Description
<i>Inbound Activities</i>	
Manage logistics and receive inventory.	<ul style="list-style-type: none">• Receive materials and process related information.• Document goods received and goods returned.• Record the transfer of materials from receiving activity to operations.• Safeguard goods received.
<i>Operations</i>	
Process product costs.	<ul style="list-style-type: none">• Develop standard costs of producing products.• Record costs incurred to produce inventory.• Determine variances from standard costs.• Maintain records of finished products stored and available for sale.
<i>Outbound Activities</i>	
Process and ship customer orders.	<ul style="list-style-type: none">• Process valid customer orders.• Document shipments made and forward information to accounts receivable.
Process accounts receivable.	<ul style="list-style-type: none">• Prepare and record invoices for authorized shipments.• Record authorized sales returns and allowance.• Maintain accounts receivable records.

Example Routine Business Processes/Major Transactions	
Summary	Description
<i>Procurement</i>	
Authorize purchases.	<ul style="list-style-type: none"> • Record authorized purchase orders. • Prevent unauthorized use of purchase orders.
Process accounts payable.	<ul style="list-style-type: none"> • Record invoices for authorized purchases. • Record returns and allowances for all authorized credits. • Maintain complete and accurate accounts payable records.
<i>Process Funds</i>	
Cash receipts.	<ul style="list-style-type: none"> • Record cash receipts.
Cash disbursements.	<ul style="list-style-type: none"> • Authorize cash disbursements. • Record cash disbursements.
Safeguard assets.	<ul style="list-style-type: none"> • Safeguard cash and related accounting records and source documents.
<i>Investment and Finance</i>	
Process investment transactions.	<ul style="list-style-type: none"> • Record authorized investment purchases and sales. • Capture and record other investment activity.
Process finance transactions.	<ul style="list-style-type: none"> • Record authorized lending activity. • Capture and record equity transactions.
<i>Fixed Assets</i>	
Record fixed-asset activity.	<ul style="list-style-type: none"> • Capture and record fixed-asset acquisitions. • Capture and record fixed-asset dispositions. • Record depreciation.
Safeguard assets.	<ul style="list-style-type: none"> • Safeguard fixed assets from loss through theft.

Example Routine Business Processes/Major Transactions	
Summary	Description
<i>Payroll</i>	
Process payroll.	<ul style="list-style-type: none">• Calculate and record payroll, including payroll deductions.
<i>Tax Compliance</i>	
Process tax compliance.	<ul style="list-style-type: none">• Process, prepare, and file required tax documents.• Record the effect of tax transactions or economic events.

Example Inquiries to Identify Changes to Internal Control

PURPOSE

This form has been designed to

- Help you identify changes to internal control that should be considered when planning your assessment of internal control effectiveness

INSTRUCTIONS

When planning your assessment of internal control effectiveness, you should identify changes to internal control that have been made (or should have been made) since your last assessment. The guidelines and example inquiries presented here may be used to help you identify these changes.

EXAMPLE INQUIRIES TO IDENTIFY CHANGES TO INTERNAL CONTROL

As part of planning an assessment of internal control effectiveness you should update your understanding of significant processes and major transactions. Determine whether your previous understanding of the company's information processing stream remains relevant and, if not, make any required changes to the company's documentation of internal control to reflect your updated knowledge. Your primary method for gathering information will be inquiries of company personnel. When making these inquiries

- Expand your inquiries to include those outside of management. Ask people who perform control procedures and process information as part of their daily job requirements.
- Make inquiries of those outside of the accounting department, for example, individuals involved in operations.

Your inquiries should be designed to gather information about

- Changes in the company's business activities that have resulted in new or increased risks
- Whether and how specific information processes and related controls were changed in response to new or increased risks

- Changes to information processes or controls that should have been made based on previously identified internal control deficiencies
- Other changes to processes, controls, or transactions

EXAMPLE INQUIRIES

Consider asking the following questions of company personnel or business process owners.

- Over the past year, what have been the most significant changes to the following?
 - The business environment in which the company operates
 - Company personnel, especially those with information processing or control duties
 - Information technology
 - Lines of business
 - Accounting and financial reporting standards that affect the company
- What effect have these changes had on the company's
 - Operations
 - Types of transactions entered into or counterparties to those transactions
 - Ability to capture, process, or report financial information
- How has company growth or retrenchment affected
 - Operations
 - Types of transactions entered into or counterparties to those transactions
 - Ability to capture, process, or report financial information
- How has the company modified its information processing and controls to respond to new financial reporting risks?
- What internal control deficiencies were identified as part of previous assessments of internal control effectiveness? During the past year, what additional weaknesses has management identified?
- What actions has management taken in response to known internal control weaknesses, those identified both by the auditors and by management?¹
- What kinds of accounting system or financial reporting errors
 - Persist
 - Have surfaced in the past year
- What other changes, not yet discussed, has management made to its
 - Financial information processing system and related controls
 - Internal control
- Why were these changes made?

¹ You should consider management's response to known internal control weaknesses, or lack of a response, when evaluating the entity's control environment.

Summary of Control Deficiencies

PURPOSE

This form has been designed to

- Summarize *all* internal control deficiencies identified during your assessment of internal control, even those that were corrected prior to year-end
- Summarize the actions taken to correct these control deficiencies and to retest the effectiveness of the new controls
- Provide the principal executive and financial officers with critical information they need to prepare their report on internal control effectiveness

INSTRUCTIONS

Summarize Control Deficiencies

All control deficiencies identified during your internal control assessment project should be brought forward and summarized on this form. *All* identified deficiencies, even those that are successfully corrected prior to year-end, should be included on this form. Control deficiencies may be identified from several sources, including the following.

- The observation of conditions listed in paragraphs 139 and 140 of PCAOB Auditing Standard No. 2, which provide definitive guidance on items that are considered to be de facto significant control deficiencies
- Communications from the external auditors, regulators, or others who have evaluated internal control
- Findings of the company's internal auditors
- The results of your review of the adequacy of your company's internal control documentation
- The results of your tests of internal control effectiveness

During your tests of internal control, you may encounter testing exceptions. Not all control testing exceptions are considered to be control deficiencies. For example, a control with an observed negligible deviation rate is *not* a control deficiency. Control testing exceptions should *not* be summarized on this form—only the underlying control deficiency, if any.

The first two columns of this form provide space for you to briefly describe the control deficiency and provide a reference to where further details can be found. To make this form easier to use, we have divided it into four different sections, according to the source of the identified deficiency.

- I. Summarizes conditions listed in paragraphs 139 and 140 of PCAOB Auditing Standard No. 2
- II. Summarizes internal control deficiencies communicated from external auditors, regulators, internal auditors, or others
- III. Summarizes the control deficiencies identified during the review of internal control documentation
- IV. Summarizes the control deficiencies identified during the testing of control operating effectiveness

Evaluate Significance

Once the control deficiency has been identified, you should evaluate its significance as

- Inconsequential
- A significant deficiency
- A material weakness

Paragraphs 8–10 of PCAOB Auditing Standard No. 2 provide the definitions of *control deficiency*, *significant deficiency*, and *material weakness*. For your convenience, those definitions have been attached as an appendix to the instructions of this form.

To evaluate the significance of control deficiencies, you should adapt and apply the guidance for auditors found in

- Paragraphs 139 and 140 of PCAOB Auditing Standard No. 2
- Appendix D of PCAOB Auditing Standard No. 2
- Answers to Q11–Q15 and Q35 of PCAOB Staff Questions and Answers (June 23, 2004 and November 22, 2004)

For your convenience, this guidance has been attached as an appendix to the instructions of this form.

You should indicate your initial evaluation of the significance of the control deficiency by marking the appropriate box of the attached form.

After evaluating control deficiencies *individually*, you should consider whether

- A combination of deficiencies considered inconsequential constitutes a significant deficiency
- A combination of individual significant deficiencies constitutes a material weakness

Document Corrective Action

The project team should take action to correct control deficiencies. Use this form to reference a detailed discussion of the corrective action taken. Additionally, all changes to internal control—such as those required to correct control deficiencies—should be reflected in

the company's internal control documentation. You should reference where this updated documentation can be found.

Document Retesting of the Control

Corrected controls must be retested to evaluate their operating effectiveness. Use this form to indicate the date as of which the corrected control was retested, including the review of the updated internal control documentation. Indicate a reference to where the documentation of these retests can be found.

Final Assessment of Effectiveness

Based on the results of the tests of the corrected control, you should make a final assessment of the effectiveness of the control at year-end.

Footnoted comments in italics are additional instructions to the preparer of the form and should be removed before the form is considered final.

APPENDIXES TO INSTRUCTIONS

DEFINITIONS OF CONTROL DEFICIENCIES PARAGRAPHS 8–10 OF PCAOB AUDITING STANDARD NO. 2

8. 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 misstatements on a timely basis.
 - A deficiency in *design* exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective is not always met.
 - A deficiency in *operation* exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.
9. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the company's ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the company's annual or interim financial statements that is more than inconsequential will not be prevented or detected.

Note: The term "remote likelihood" as used in the definitions of *significant deficiency* and *material weakness* (paragraph 10) has the same meaning as the term "remote" as used in Financial Accounting Standards Board Statement No. 5, *Accounting for Contingencies* (FAS No. 5). Paragraph 3 of FAS No. 5 states: "When a loss contingency exists, the likelihood that the future event or events will

confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote.” This statement uses the terms “probable,” “reasonably possible,” and “remote” to identify three areas within that range, as follows:

- a. *Probable*. The future event or events are likely to occur.
- b. *Reasonably possible*. The chance of the future event or events occurring is more than remote but less than likely.
- c. *Remote*. The chance of the future events or events occurring is slight.

Therefore, the likelihood of an event is “more than remote” when it is either reasonably possible or probable.

Note: A misstatement is *inconsequential* if a reasonable person would conclude, after considering the possibility of further undetected misstatements, that the misstatement, either individually or when aggregated with other misstatements, would clearly be immaterial to the financial statements. If a reasonable person could not reach such a conclusion regarding a particular misstatement, that misstatement is *more than inconsequential*.

10. A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Note: In evaluating whether a control deficiency exists and whether control deficiencies, either individually or in combination with other control deficiencies, are significant deficiencies or material weaknesses, the auditor should consider the definitions in paragraphs 8, 9, and 10, and the directions in paragraphs 130–137. As explained in paragraph 23, the evaluation of the materiality of the control deficiency should include both quantitative and qualitative considerations. Qualitative factors that might be important in this evaluation include the nature of the financial statement accounts and assertions involved and the reasonably possible future consequences of the deficiency.

Furthermore, in determining whether a control deficiency or combination of deficiencies is a significant deficiency or a material weakness, the auditor should evaluate the effect of compensating controls and whether such compensating controls are effective.

EVALUATING THE SIGNIFICANCE OF CONTROL DEFICIENCIES PARAGRAPHS 130–140 OF PCAOB AUDITING STANDARD NO. 2

130. Evaluating deficiencies in internal control over financial reporting. The auditor must evaluate identified control deficiencies and determine whether the deficiencies, individually or in combination, are significant deficiencies or material weaknesses. The evaluation of the significance of a deficiency should include both quantitative and qualitative factors.

131. The auditor should evaluate the significance of a deficiency in internal control over financial reporting initially by determining the following:
- The likelihood that a deficiency, or a combination of deficiencies, could result in a misstatement of an account balance or disclosure
 - The magnitude of the potential misstatement resulting from the deficiency or deficiencies
132. The significance of a deficiency in internal control over financial reporting depends on the potential for a misstatement, not on whether a misstatement actually has occurred.
133. Several factors affect the likelihood that a deficiency, or a combination of deficiencies, could result in a misstatement of an account balance or disclosure. The factors include, but are not limited to, the following:
- The nature of the financial statement accounts, disclosures, and assertions involved; for example, suspense accounts and related-party transactions involve greater risk.
 - The susceptibility of the related assets or liability to loss or fraud; that is, greater susceptibility increases risk.
 - The subjectivity, complexity, or extent of judgment required to determine the amount involved; that is, greater subjectivity, complexity, or judgment, like that related to an accounting estimate, increases risk.
 - The cause and frequency of known or detected exceptions for the operating effectiveness of a control; for example, a control with an observed nonnegligible deviation rate is a deficiency.
 - The interaction or relationship of the control with other controls; that is, the interdependence or redundancy of the control.
 - The interaction of the deficiencies; for example, when evaluating a combination of two or more deficiencies, whether the deficiencies could affect the same financial statement accounts and assertions.
 - The possible future consequences of the deficiency.
134. When evaluating the likelihood that a deficiency or combination of deficiencies could result in a misstatement, the auditor should evaluate how the controls interact with other controls. There are controls, such as information technology general controls, on which other controls depend. Some controls function together as a group of controls. Other controls overlap, in the sense that these other controls achieve the same objective.
135. Several factors affect the magnitude of the misstatement that could result from a deficiency or deficiencies in controls. The factors include, but are not limited to, the following:
- The financial statement amounts or total of transactions exposed to the deficiency
 - The volume of activity in the account balance or class of transactions exposed to the deficiency that has occurred in the current period or that is expected in future periods

136. In evaluating the magnitude of the potential misstatement, the auditor should recognize that the maximum amount that an account balance or total of transactions can be overstated is generally the recorded amount. However, the recorded amount is not a limitation on the amount of potential understatement. The auditor also should recognize that the risk of misstatement might be different for the maximum possible misstatement than for lesser possible amounts.
137. When evaluating the significance of a deficiency in internal control over financial reporting, the auditor also should determine the level of detail and degree of assurance that would satisfy prudent officials in the conduct of their own affairs that they have reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in conformity with generally accepted accounting principles. If the auditor determines that the deficiency would prevent prudent officials in the conduct of their own affairs from concluding that they have reasonable assurance, then the auditor should deem the deficiency to be at least a significant deficiency. Having determined in this manner that a deficiency represents a significant deficiency, the auditor must further evaluate the deficiency to determine whether individually, or in combination with other deficiencies, the deficiency is a material weakness.

Note: Paragraphs 9 and 10 provide the definitions of *significant deficiency* and *material weakness*, respectively.

138. Inadequate documentation of the design of controls and the absence of sufficient documented evidence to support management's assessment of the operating effectiveness of internal control over financial reporting are control deficiencies. As with other control deficiencies, the auditor should evaluate these deficiencies as to their significance.
139. The interaction of qualitative considerations that affect internal control over financial reporting with quantitative considerations ordinarily results in deficiencies in the following areas being at least significant deficiencies in internal control over financial reporting:
- Controls over the selection and application of accounting policies that are in conformity with generally accepted accounting principles
 - Antifraud programs and controls
 - Controls over nonroutine and nonsystematic transactions
 - Controls over the period-end financial reporting process, including controls over procedures used to enter transaction totals into the general ledger; initiate, authorize, record, and process journal entries into the general ledger; and record recurring and nonrecurring adjustments to the financial statements
140. Each of the following circumstances should be regarded as at least a significant deficiency and as a strong indicator that a material weakness in internal control over financial reporting exists:
- Restatement of previously issued financial statements to reflect the correction of a misstatement

Note: The correction of a misstatement includes misstatements due to error or fraud; it does not include restatements to reflect a change in accounting principle to comply with a new accounting principle or a voluntary change from one generally accepted accounting principle to another generally accepted accounting principle.

- Identification by the auditor of a material misstatement in financial statements in the current period that was not initially identified by the company's internal control over financial reporting. (This is a strong indicator of a material weakness even if management subsequently corrects the misstatement.)
- Oversight of the company's external financial reporting and internal control over financial reporting by the company's audit committee is ineffective. (Paragraphs 55–59 present factors to evaluate when determining whether the audit committee is ineffective.)
- The internal audit function or the risk assessment function is ineffective at a company for which such a function needs to be effective for the company to have an effective monitoring or risk assessment component, such as for very large or highly complex companies.

Note: The evaluation of the internal audit or risk assessment functions is similar to the evaluation of the audit committee, as described in paragraphs 55–59; that is, the evaluation is made within the context of the monitoring and risk assessment components. The auditor is not required to make a separate evaluation of the effectiveness and performance of these functions. Instead, the auditor should base his or her evaluation on evidence obtained as part of evaluating the monitoring and risk assessment components of internal control over financial reporting.

- For complex entities in highly regulated industries, an ineffective regulatory compliance function. This relates solely to those aspects of the ineffective regulatory compliance function in which associated violations of laws and regulations could have a material effect on the reliability of financial reporting.
- Identification of fraud of any magnitude on the part of senior management.

Note: The auditor is required to plan and perform procedures to obtain reasonable assurance that material misstatement caused by fraud is detected by the auditor. However, for the purposes of evaluating and reporting deficiencies in internal control over financial reporting, the auditor should evaluate fraud of any magnitude (including fraud resulting in immaterial misstatements) on the part of senior management of which he or she is aware. Furthermore, for the purposes of this circumstance, “senior management” includes the principal executive and financial officers signing the company's certifications as required under Section 302 of the act as well as any other member of management who plays a significant role in the company's financial reporting process.

- Significant deficiencies that have been communicated to management and the audit committee remain uncorrected after some reasonable period of time.
- An ineffective control environment.

EXAMPLES OF SIGNIFICANT DEFICIENCIES AND MATERIAL WEAKNESSES (APPENDIX D OF PCAOB AUDITING STANDARD NO. 2)

- D1. Paragraph 8 of this standard defines a control deficiency. Paragraphs 9 and 10 go on to define a significant deficiency and a material weakness, respectively.
- D2. Paragraphs 22–23 of this standard discuss materiality in an audit of internal control over financial reporting, and paragraphs 130–140 provide additional direction on evaluating deficiencies in internal control over financial reporting.
- D3. The following examples illustrate how to evaluate the significance of internal control deficiencies in various situations. These examples are for illustrative purposes only.

Example D-1: Reconciliations of Intercompany Accounts Are Not Performed on a Timely Basis

SCENARIO A—SIGNIFICANT DEFICIENCY

The company processes a significant number of routine intercompany transactions on a monthly basis. Individual intercompany transactions are not material and primarily relate to balance sheet activity, for example, cash transfers between business units to finance normal operations.

A formal management policy requires monthly reconciliation of intercompany accounts and confirmation of balances between business units. However, there is not a process in place to ensure performance of these procedures. As a result, detailed reconciliations of intercompany accounts are not performed on a timely basis.

Management does perform monthly procedures to investigate selected large-dollar intercompany account differences. In addition, management prepares a detailed monthly variance analysis of operating expenses to assess their reasonableness.

Based only on these facts, the auditor should determine that this deficiency represents a significant deficiency for the following reasons: The magnitude of a financial statement misstatement resulting from this deficiency would reasonably be expected to be more than inconsequential, but less than material, because individual intercompany transactions are not material, and the compensating controls operating monthly should detect a material misstatement. Furthermore, the transactions are primarily restricted to balance sheet accounts. However, the compensating detective controls are designed only to detect material misstatements. The controls do not address the detection of misstatements that are more than inconsequential but less than material. Therefore, the likelihood that a misstatement that was more than inconsequential, but less than material, could occur is more than remote.

SCENARIO B—MATERIAL WEAKNESS

The company processes a significant number of intercompany transactions on a monthly basis. Intercompany transactions relate to a wide range of activities, including transfers of inventory with intercompany profit between business units, allocation of research and development costs to business units, and corporate charges. Individual intercompany transactions are frequently material.

A formal management policy requires monthly reconciliation of intercompany accounts and confirmation of balances between business units. However, there is not a process in place to ensure that these procedures are performed on a consistent basis. As a result, reconciliations of intercompany accounts are not performed on a timely basis, and differences in intercompany accounts are frequent and significant. Management does not perform any alternative controls to investigate significant intercompany account differences.

Based only on these facts, the auditor should determine that this deficiency represents a material weakness for the following reasons: The magnitude of a financial statement misstatement resulting from this deficiency would reasonably be expected to be material, because individual intercompany transactions are frequently material and relate to a wide range of activities. Additionally, actual unreconciled differences in intercompany accounts have been, and are, material. The likelihood of such a misstatement is more than remote because such misstatements have frequently occurred and compensating controls are not effective, because they are either not properly designed or not operating effectively. Taken together, the magnitude and likelihood of misstatement of the financial statements resulting from this internal control deficiency meet the definition of a material weakness.

Example D-2: Modifications to Standard Sales Contract Terms Not Reviewed to Evaluate Impact on Timing and Amount of Revenue Recognition

SCENARIO A—SIGNIFICANT DEFICIENCY

The company uses a standard sales contract for most transactions. Individual sales transactions are not material to the entity. Sales personnel are allowed to modify sales contract terms. The company's accounting function reviews significant or unusual modifications to the sales contract terms, but does not review changes in the standard shipping terms. The changes in the standard shipping terms could require a delay in the timing of revenue recognition. Management reviews gross margins on a monthly basis and investigates any significant or unusual relationships. In addition, management reviews the reasonableness of inventory levels at the end of each accounting period. The entity has experienced limited situations in which revenue has been inappropriately recorded in advance of shipment, but amounts have not been material.

Based only on these facts, the auditor should determine that this deficiency represents a significant deficiency for the following reasons: The magnitude of a financial statement misstatement resulting from this deficiency would reasonably be expected to be more than inconsequential, but less than material, because individual sales transactions are not material and the compensating detective controls operating monthly and at the end of each financial reporting period should reduce the likelihood of a material misstatement going undetected. Furthermore, the risk of material misstatement is limited to revenue recognition errors related to shipping terms as opposed to broader sources of error in revenue recognition. However, the compensating detective controls are only designed to detect material misstatements. The controls do not effectively address the detection of misstatements that are more than inconsequential but less than material, as evidenced by situations in which transactions that were not material were improperly recorded. Therefore, there is a more than remote likelihood that a misstatement that is more than inconsequential but less than material could occur.

SCENARIO B—MATERIAL WEAKNESS

The company has a standard sales contract, but sales personnel frequently modify the terms of the contract. The nature of the modifications can affect the timing and amount of revenue recognized. Individual sales transactions are frequently material to the entity, and the gross margin can vary significantly for each transaction.

The company does not have procedures in place for the accounting function to regularly review modifications to sales contract terms. Although management reviews gross margins on a monthly basis, the significant differences in gross margins on individual transactions make it difficult for management to identify potential misstatements. Improper revenue recognition has occurred, and the amounts have been material.

Based only on these facts, the auditor should determine that this deficiency represents a material weakness for the following reasons: The magnitude of a financial statement misstatement resulting from this deficiency would reasonably be expected to be material, because individual sales transactions are frequently material, and gross margin can vary significantly with each transaction (which would make compensating detective controls based on a reasonableness review ineffective). Additionally, improper revenue recognition has occurred, and the amounts have been material. Therefore, the likelihood of material misstatements occurring is more than remote. Taken together, the magnitude and likelihood of misstatement of the financial statements resulting from this internal control deficiency meet the definition of a material weakness.

SCENARIO C—MATERIAL WEAKNESS

The company has a standard sales contract, but sales personnel frequently modify the terms of the contract. Sales personnel frequently grant unauthorized and unrecorded sales discounts to customers without the knowledge of the accounting department. These amounts are deducted by customers in paying their invoices and are recorded as outstanding balances on the accounts receivable aging. Although these amounts are individually insignificant, they are material in the aggregate and have occurred consistently over the past few years.

Based on only these facts, the auditor should determine that this deficiency represents a material weakness for the following reasons: The magnitude of a financial statement misstatement resulting from this deficiency would reasonably be expected to be material, because the frequency of occurrence allows insignificant amounts to become material in the aggregate. The likelihood of material misstatement of the financial statements resulting from this internal control deficiency is more than remote (even assuming that the amounts were fully reserved for in the company's allowance for uncollectible accounts) due to the likelihood of material misstatement of the gross accounts receivable balance. Therefore, this internal control deficiency meets the definition of a material weakness.

Example D-3: Identification of Several Deficiencies**SCENARIO A—MATERIAL WEAKNESS**

During its assessment of internal control over financial reporting, management identified the following deficiencies. Based on the context in which the deficiencies occur, manage-

ment and the auditor agree that these deficiencies individually represent significant deficiencies:

- Inadequate segregation of duties over certain information system access controls
- Several instances of transactions that were not properly recorded in subsidiary ledgers; transactions were not material, either individually or in the aggregate
- A lack of timely reconciliations of the account balances affected by the improperly recorded transactions.

Based only on these facts, the auditor should determine that the combination of these significant deficiencies represents a material weakness for the following reasons: Individually, these deficiencies were evaluated as representing a more than remote likelihood that a misstatement that is more than inconsequential, but less than material, could occur. However, each of these significant deficiencies affects the same set of accounts. Taken together, these significant deficiencies represent a more than remote likelihood that a material misstatement could occur and not be prevented or detected. Therefore, in combination, these significant deficiencies represent a material weakness.

SCENARIO B—MATERIAL WEAKNESS

During its assessment of internal control over financial reporting, management of a financial institution identifies deficiencies in the design of controls over the estimation of credit losses (a critical accounting estimate); the operating effectiveness of controls for initiating, processing, and reviewing adjustments to the allowance for credit losses; and the operating effectiveness of controls designed to prevent and detect the improper recognition of interest income. Management and the auditor agree that, in their overall context, each of these deficiencies individually represents a significant deficiency.

In addition, during the past year, the company experienced a significant level of growth in the loan balances that were subjected to the controls governing credit loss estimation and revenue recognition, and further growth is expected in the upcoming year.

Based only on these facts, the auditor should determine that the combination of these significant deficiencies represents a material weakness for the following reasons:

- The balances of the loan accounts affected by these significant deficiencies have increased over the past year and are expected to increase in the future.
- This growth in loan balances, coupled with the combined effect of the significant deficiencies described, results in a more than remote likelihood that a material misstatement of the allowance for credit losses or interest income could occur.

Therefore, in combination, these deficiencies meet the definition of a material weakness.

ADDITIONAL GUIDANCE ON EVALUATING CONTROL DEFICIENCIES

PCAOB STAFF QUESTIONS AND ANSWERS (JUNE 23, 2004)

Q11. The definition of a significant deficiency is based, in part, on a magnitude of financial statement misstatement that is “more than inconsequential.” Paragraphs E87–E91 of Auditing Standard No. 2 describe the development of the board’s definition of the term *inconsequential*. The definition is based on paragraph .41 of AU sec. 312, *Audit Risk and Materiality in Conducting an Audit*, which states:

In aggregating likely misstatements that the entity has not corrected, pursuant to paragraphs .34 and .35 [of AU sec. 312], the auditor may designate an amount below which misstatements need not be accumulated. This amount should be set so that any such misstatements, either individually or when aggregated with other such misstatements, would not be material to the financial statements, after the possibility of further undetected misstatements is considered.

In the audit of the financial statements, different auditors designate the amount described in paragraph .41 of AU sec. 312 in various ways. Some auditors quantify, during the planning phase of the audit, a specific dollar amount above which likely misstatements will be accumulated. Others take a more judgmental approach to determining which likely misstatements to accumulate. Of the auditors who quantify a specific dollar amount above which likely misstatements will be accumulated, different auditors use different methodologies to arrive at different thresholds or specific dollar amounts.

Given the relationship of paragraph .41 of AU sec. 312 to the definition of *inconsequential*, is a known or likely misstatement aggregated by the auditor during the audit of the financial statements in response to the directions in paragraph .41 of AU sec. 312 by definition “more than inconsequential”? Furthermore, by virtue of having been aggregated by the auditor, such a misstatement would have a “more than remote likelihood” of occurring; therefore, by extension, does the aggregation of a difference by the auditor, by definition, mean that there is a significant deficiency in the company’s internal control over financial reporting?

A11. No. A known or likely misstatement aggregated by the auditor as part of the audit of the financial statements is not, by definition, either “more than inconsequential” or determinative of there being a significant deficiency. There are several reasons and circumstances why such a likely misstatement aggregated by the auditor might or might not indicate the existence of a significant deficiency.

The threshold for “more than inconsequential” when evaluating whether a significant deficiency exists is not necessarily the same as the amount the auditor establishes pursuant to paragraph .41 of AU section 312 for aggregating misstatements. The definition of *inconsequential* includes a combination of concepts from both Staff Accounting Bulletin (SAB) No. 99, *Materiality*, and AU sec. 312. The definition of *inconsequential* is largely based on the discussion of magnitude in SAB No. 99 and on AU sec. 312 for its directions regarding

both the consideration of misstatements individually and in the aggregate as well as the possibility of undetected misstatements.

Also, as the board indicated in paragraph E75 of the Background and Basis for Conclusions of Auditing Standard No. 2, one reason that a significant deficiency is defined differently from the previously used term “reportable condition” is because the definition of *reportable condition* was solely a matter of the auditor’s judgment. A definition dependent *solely* on the auditor’s judgment was insufficient for purposes of the Sarbanes-Oxley Act because management also needs a definition to determine whether a deficiency is significant, and that definition should be the same as the definition used by the auditor. Accordingly, Auditing Standard No. 2’s definition of *significant deficiency* is not, by definition, the same as the auditor’s threshold for aggregating likely misstatements in the audit of the financial statements.

As indicated in the question, different auditors exercise their professional judgment in different ways in different circumstances when accumulating likely misstatements as part of the audit of the financial statements. Furthermore, some auditors, as a matter of policy, tend to set their posting threshold for accumulating likely misstatements lower than “inconsequential.” For example, some auditors set their posting threshold for accumulating likely misstatements at .25 percent of the company’s pretax income, which would, in most cases, be clearly inconsequential on a quantitative basis.

Because a likely misstatement aggregated by the auditor as part of the audit of the financial statements is not, by definition, “more than inconsequential” or determinative of the existence of a significant deficiency, the auditor need not align the amount above which he or she aggregates misstatements with the amount above which he or she believes a misstatement to be “more than inconsequential” or determinative of the existence of a significant deficiency.

Furthermore, the auditor should not, for example, change the types of deficiencies that he or she determines to be significant deficiencies simply by raising the auditor’s threshold for accumulating likely misstatements. These determinations also need to take into consideration qualitative, as well as quantitative, factors. The auditor might still determine that there is a more than remote likelihood that a misstatement *larger* than the difference on his or her summary of audit differences might occur and not be prevented or detected. For these reasons, it is possible that a control deficiency associated with a likely misstatement accumulated by the auditor on his or her summary of audit differences might indicate the existence of a deficiency, a significant deficiency, or a material weakness.

Q12. When determining whether a control deficiency exists, should the auditor consider compensating controls?

A12. No. The note to paragraph 10 of Auditing Standard No. 2 states that “. . . in determining whether a control deficiency or combination of deficiencies is a significant deficiency or a material weakness, the auditor should evaluate the effect of compensating controls and whether such compensating controls are effective.” An important part of the evaluation of whether a significant deficiency or material weakness exists includes aggregating deficiencies and considering their effect in combination. The logical extension of this aggregation is to also consider compensating controls. However, control deficiencies should be considered individually and in isolation; therefore, the existence of compensating controls does not affect whether a control deficiency exists.

Q13. Are all control testing exceptions, by definition, control deficiencies?

A13. No. Paragraph 107 of Auditing Standard No. 2 states: “A conclusion that an identified exception does not represent a control deficiency is appropriate only if evidence beyond what the auditor had initially planned and beyond inquiry supports that conclusion.” Paragraph 133 also includes the example that “a control with an observed non-negligible deviation rate is a deficiency.” Both these passages in the standard recognize the inherent limitations in internal control. Effective internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting.

Because effective internal control over financial reporting cannot, and does not, provide absolute assurance of achieving financial reporting objectives, any individual control does not necessarily have to operate perfectly, all the time, to be considered effective. Therefore, Auditing Standard No. 2 provides the auditor with directions that allow the use of judgment in the circumstances in which he or she is evaluating whether a control testing exception is a control deficiency.

Q14. When a control deficiency exists, what degree of precision is required for a compensating control to effectively mitigate a significant deficiency or material weakness?

A14. As discussed in A13, Auditing Standard No. 2 provides that auditors should evaluate the effect of compensating controls when determining whether a control deficiency or combination of deficiencies is a significant deficiency or a material weakness. However, to have a mitigating effect, the compensating control should operate at a level of precision that would prevent or detect a misstatement that was more than inconsequential or material, respectively.

Q15. Paragraph 9 of Auditing Standard No. 2 defines a significant deficiency as “a control deficiency, or combination of control deficiencies . . .” Paragraph 10 defines a material weakness as “a significant deficiency, or combination of significant deficiencies . . .” The definition of a material weakness, therefore, relies on the definition of a significant deficiency. Does this mean that a control deficiency, once determined to be only a control deficiency and not also a significant deficiency, could be excluded from the evaluation of whether a significant deficiency or combination of significant deficiencies constitutes a material weakness?

A15. No. The definitions of *significant deficiency* and *material weakness* delineate increasingly severe types of control deficiencies. All significant deficiencies are also deficiencies; all material weaknesses are also significant deficiencies and deficiencies. If the auditor correctly aggregates control deficiencies when evaluating whether a significant deficiency exists, then all related and salient control deficiencies will also be included in the auditor’s evaluation of whether a combination of significant deficiencies represents a material weakness. Therefore, whether the definition of a material weakness is expressed as “a significant deficiency, or combination of significant deficiencies . . .” or as “a control deficiency, or combination of control deficiencies . . .” is unimportant. Both the meaning and the evaluation are the same.

ASSESSMENT OF INTERNAL CONTROL EFFECTIVENESS SUMMARY OF CONTROL DEFICIENCIES

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

We have evaluated all control deficiencies identified during our evaluation of internal control effectiveness and assessed their relative significance. Our definitions of *control deficiency*, *significant deficiency*, and *material weakness* are the same as those provided in paragraphs 8–10 of PCAOB Auditing Standard No. 2. Our process for evaluating the significance of control deficiencies followed closely the guidance provided in

- Paragraphs 130–140 of PCAOB Auditing Standard No. 2
- Appendix D of PCAOB Auditing Standard No. 2
- Answers to questions 11–15 of PCAOB Staff Questions and Answers (June 23, 2004)
- Answer to Q35 of PCAOB Staff Questions and Answers (November 22, 2004)

This form summarizes

- All control deficiencies identified during our assessment of internal control
- Our preliminary judgment as to the relative significance of those deficiencies, both individually and in the aggregate
- Corrective action taken, including the updating of internal control documentation
- The retesting of the corrected control
- A final evaluation of control effectiveness as of year-end

SUMMARY OF CONTROL DEFICIENCIES DEFINED BY PARAGRAPHS 139 AND 140 OF PCAOB AUDITING STANDARD NO. 2

			Initial Evaluation of Significance			Reference to Corrective Action			Reference to Retesting		Evaluation of Control Effectiveness at Reporting Date		
Ref.	Description	Present?	Inconsequential	Significant Deficiency	Mat. Weak	New Control	Correct Control	Update Doc.	Date	Ref.	Control Effective	Significant Deficiency	Mat. Weak
At least significant deficiency													
	Controls over election and application of accounting policies	Y N											
	Antifraud controls	Y N											
	Controls over nonroutine transactions	Y N											
	Controls over period-end reporting process	Y N											
At least significant deficiency and strong indicator of material weakness													
	Restatement of financial statements	Y N											

[illegible]

SUMMARY OF CONTROL DEFICIENCIES COMMUNICATED FROM OTHERS

Ref.	Description	Initial Evaluation of Significance			Reference to Corrective Action			Reference to Retesting		Evaluation of Significance at Reporting Date		
		Incon-sequential	Significant Deficiency	Mat. Weak	New Control	Correct Control	Update Doc.	Date	Ref.	Incon-sequential	Significant Deficiency	Mat. Weak

SUMMARY OF CONTROL DEFICIENCIES IDENTIFIED DURING REVIEW OF INTERNAL CONTROL DOCUMENTATION

[illegible]

SUMMARY OF CONTROL DEFICIENCIES IDENTIFIED DURING TESTS OF CONTROL OPERATING EFFECTIVENESS

Ref.	Description	Initial Evaluation of Significance			Reference to Corrective Action			Reference to Retesting		Evaluation of Significance at Reporting Date		
		Incon-sequential	Significant Deficiency	Mat. Weak	New Control	Correct Control	Update Doc.	Date	Ref.	Incon-sequential	Significant Deficiency	Mat. Weak

EVALUATION OF AGGREGATED INCONSEQUENTIAL DEFICIENCIES

We considered whether a combination of control deficiencies, which were considered inconsequential individually, could constitute a significant deficiency when aggregated. The following combination of control deficiencies, when taken together, constitute a significant deficiency.

EVALUATION OF AGGREGATED SIGNIFICANT DEFICIENCIES

We considered whether a combination of control deficiencies, which were considered to be significant individually, could constitute a material weakness when aggregated. The following combination of significant deficiencies, when taken together, constitute a material weakness.

Senior Management Review Checklist

PURPOSE

This form has been designed to

- Guide the principal executive officer and principal financial officer in their participation, supervision, and review of the company's assessment of internal control effectiveness
- Provide documentation of the nature, timing, and extent of senior management's active involvement in the company's process for evaluating internal control

INSTRUCTIONS

The company's principal executive officer and principal financial officer bear the ultimate responsibility for the effectiveness of the company's internal control over financial reporting. In addition, these officers must take responsibility for

- The evaluation of the effectiveness of the company's internal control
- The sufficiency of the evidence supporting the evaluation of internal control effectiveness
- The preparation of the written assessment of internal control effectiveness as of year-end.

This checklist will help the company's principal executive and financial officers fulfill these responsibilities.

To indicate that the step was completed, initial in the "Done by" space provided and indicate the date when the step was performed. To perform the steps, the program will require you to

- Review relevant documentation
- Make inquiries of the project team leader
- Observe the work of the project team

You also will be required to understand and evaluate key decisions *throughout the entire assessment process*.

**ASSESSMENT OF INTERNAL CONTROL EFFECTIVENESS
SENIOR MANAGEMENT REVIEW CHECKLIST**

Company: _____ Reporting Date: _____

Prepared by: _____

This form summarizes the nature and timing of the involvement of the company’s principal executive officer and its principal financial officer in the company’s process for assessing internal control effectiveness.

	Done By	Date
<i>Project Planning</i>		
1. Review the composition of the project team and satisfy yourself that		
a. The team as a whole has the skills to perform the work competently.	_____	_____
b. The project manager has sufficient status within the company to ensure sufficient internal control testing coverage and adequate consideration of, and actions on, the findings and recommendations of the individuals performing the testing.	_____	_____
2. Determine that the resources allocated to the project are adequate.	_____	_____
3. Review the list of information sources used by the project team and determine that all internal control–related matters of which you are aware (e.g., communications from external auditors) have been made available to the project team.	_____	_____
4. Determine that all entity-level controls required to be tested have been included within the project scope.	_____	_____
5. Consider the company’s major transactions or business processes. Determine that all of these have been included within the scope of the project.	_____	_____
6. Obtain an understanding of the process used to select individual business units or locations and third-party information processing organizations (i.e., service organizations) that have been included within the scope of the project.	_____	_____

	Done By	Date
7. Consider other events or circumstances that posed significant project scoping issues, for example, business acquisitions or new information systems. Determine that these issues were resolved appropriately.	_____	_____
8. Review the project schedule and assess whether		
a. The planned timetable is reasonably attainable, given the project scope and resources assigned.	_____	_____
b. The scheduled completion dates will allow for the remediation of any identified control deficiencies and the testing by external auditors.	_____	_____
9. Review and monitor the communication between the project team and the company's external auditors regarding significant planning matters.	_____	_____

Documentation and Testing of Internal Control

10. Obtain an understanding of how the company's internal control documentation is created, stored, protected from unauthorized changes, and maintained.	_____	_____
11. Obtain an understanding of the procedures performed by the project team to assess the adequacy of the company's documentation of internal control and whether		
a. Controls related to <i>all</i> significant business processes and entity-level controls have been documented.	_____	_____
b. The content of the documentation contained all required elements to assess control design.	_____	_____
c. Control documentation reflects current operating practices.	_____	_____
12. Obtain an overall understanding of the project team's tests of <i>entity-level</i> control effectiveness, including		
a. The nature of the tests performed.	_____	_____
b. The date as of which the tests were performed and the time period covered by the tests.	_____	_____
c. The extent or scope of the tests.	_____	_____

	Done By	Date
13. Obtain an overall understanding of the project team's tests of <i>activity-level</i> control effectiveness, including		
a. The nature of the tests performed.	_____	_____
b. The date as of which the tests were performed and the time period covered by the tests.	_____	_____
c. The extent of the tests, for example, the number of items selected for testing.	_____	_____

Review Findings and Evaluate

[Note: These procedures related to the review and evaluation of findings should be performed continuously, as significant phases of the project, starting with the documentation phase, are completed.]

14. Review all test results and findings of the project team, distinguishing between		
• Isolated instances of noncompliance with stated procedures		
• Control deficiencies that are		
- Inconsequential		
- Significant		
- Material weaknesses	_____	_____
15. Review the evidence supporting the conclusions reached in step 14 regarding the classification of testing exceptions and findings. Determine that the evidence adequately supports the conclusions reached.	_____	_____
16. Read all subcertifications received from business process owners. Determine that all issues raised by business process owners have been resolved appropriately.	_____	_____
16. Determine that all material weaknesses have been communicated on a timely basis to the external auditors.	_____	_____
17. Review the project team's plans for remediating material weaknesses and other control deficiencies and assess the adequacy and achievability of these plans.	_____	_____

	Done By	Date
18. Determine that all changes to internal control to remediate material weaknesses have been disclosed, if necessary, in the company's quarterly SEC filings.	_____	_____

Final Evaluation

19. Review the project team's plans for updating tests of controls performed in advance of year-end.	_____	_____
20. Understand the procedures performed to evaluate the effectiveness of control procedures implemented since the testing date, including newly designed controls to remediate control deficiencies. Assess the adequacy of those procedures.	_____	_____
21. Review the written representation letter on internal control matters to be provided to the company's external auditors. Assess the adequacy of procedures performed to support representations made, if applicable.	_____	_____

Conclusion

I have participated in the planning and performance of the company's process for evaluating internal control effectiveness. The results of the testwork performed support a conclusion that the company's internal control over financial reporting is _____ [*effective/not effective*] as of _____ [*fiscal year-end*]. We have retained sufficient evidence, including documentation, to support this evaluation.

Signed

Date

Checklist for Preparation of Management’s Report on Internal Control Effectiveness

PURPOSE

This form has been designed to

- Help ensure that management’s report on internal control effectiveness complies with SEC requirements and other suggestions

INSTRUCTIONS

Use this checklist during the preparation or review of management’s report on internal control effectiveness.

Footnoted comments in italics are additional instructions to the preparer of the form and should be removed before the form is considered final.

CHECKLIST FOR MANAGEMENT’S REPORT ON THE EFFECTIVENESS OF INTERNAL CONTROL OVER FINANCIAL REPORTING

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

REQUIRED REPORTING MATTERS

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
1. Does the report include a statement that management is responsible for establishing and maintaining adequate internal control over financial reporting?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
2. Does the report identify the framework (e.g., the COSO Internal Control Integrated Framework) used by management to evaluate the effectiveness of the company's internal control over financial reporting?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Does a material weakness in internal control over financial reporting exist as of year-end?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
a. If a material weakness in internal control does <i>not</i> exist at year-end, does the report include a statement that			
i. as of year-end . . .	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
ii. internal control over financial reporting is effective . . .	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
iii. based on the criteria in the identified framework	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. If a material weakness in internal control <i>exists as of year-end</i> , does the report include			
i. The definition of a material weakness, as provided in paragraph 10 of PCAOB Auditing Standard No. 2	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
ii. A discussion of the material weakness that includes specific information about the nature of the material weakness and its actual and potential effect on the presentation of the company's financial statements issued during the existence of the weakness	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
iii. A statement that as of year-end, internal control over financial reporting is not effective based on the criteria in the identified framework	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Does the report include adequate disclosure (see 3.b.i and 3.b.ii) of material weaknesses identified by management that were corrected during the period?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
5. Does the report include a statement that the registered accounting firm that audited the company’s financial statements has issued an assessment of the company’s internal control over financial reporting and make reference to where that report can be found?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. If the company has disclosed matters related to entities that are included in the company’s consolidated financial statements, but <i>not</i> included within the scope of management’s assessment of internal control (see items 1 and 3 in the section titled “Disclosure Matters”), does management’s report on internal control make appropriate reference to these disclosures?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

OPTIONAL REPORTING MATTERS

Indicate which of the following optional items have been included in management’s report on internal control over financial reporting. Reference the applicable documentation supporting each disclosure.

	<u>Included</u>	<u>Not Included</u>	<u>Reference</u>
1. Disclosures about corrective actions taken by the company after the date of management’s assessment	<input type="checkbox"/>	<input type="checkbox"/>	_____
2. The company’s plans to implement new controls	<input type="checkbox"/>	<input type="checkbox"/>	_____
3. A statement that management believes the cost of correcting a material weakness would exceed the benefits to be derived from implementing new controls	<input type="checkbox"/>	<input type="checkbox"/>	_____

Describe all other optional matters included in management’s report on internal control effectiveness.

DISCLOSURE MATTERS

SEC rules may require the disclosure of internal control–related matters outside of management’s report on internal control over financial reporting.

	<u>Yes</u>	<u>No</u>	<u>Reference</u>
1. Do the company’s consolidated financial statements include a variable-interest entity (VIE) that meets all of the following conditions?			
a. The VIE was in existence prior to December 15, 2003.	<input type="checkbox"/>	<input type="checkbox"/>	_____
b. It is consolidated by virtue of FASB Interpretation No. 46 (i.e., it would <i>not</i> have been consolidated in the absence of application of that guidance).	<input type="checkbox"/>	<input type="checkbox"/>	_____
c. The company does not have the right or authority to assess the internal controls of the VIE and also lacks the ability, in practice, to make that assessment.	<input type="checkbox"/>	<input type="checkbox"/>	_____
2. For VIEs that meet all of the conditions specified in item 1, has the company disclosed in the body of its Form 10-K or 10-KSB			
a. That management has not evaluated the internal controls of the VIE	<input type="checkbox"/>	<input type="checkbox"/>	_____
b. That management’s conclusion regarding the effectiveness of its internal control over financial reporting does not extend to the internal controls of the VIE	<input type="checkbox"/>	<input type="checkbox"/>	_____
c. Key subtotals, such as total and net assets, revenues, and net income that result from consolidation of the entity(ies) that have not been assessed	<input type="checkbox"/>	<input type="checkbox"/>	_____
d. That the financial statements include the accounts of certain entities consolidated pursuant to FIN 46 (or via proportionate consolidation in accordance with EITF 00-1) but that management has been unable to assess the effectiveness of internal control at those entities due to the fact that the company does not have the ability to dictate or modify the controls of the entities and does not have the ability, in practice, to assess those controls	<input type="checkbox"/>	<input type="checkbox"/>	_____
3. Has the company <i>excluded</i> from the scope of its assessment the controls at a newly acquired business?	<input type="checkbox"/>	<input type="checkbox"/>	_____

	<u>Yes</u>	<u>No</u>	<u>Reference</u>
4. If the company has excluded a newly acquired business from the scope of its assessment, does the Form 10-K or 10-KSB include disclosure of the following?			
a. A statement noting that management excluded the acquired business from management’s report on internal control over financial reporting	<input type="checkbox"/>	<input type="checkbox"/>	_____
b. The identity of the acquired business	<input type="checkbox"/>	<input type="checkbox"/>	_____
c. An indication of the significance of the acquired business to the company’s consolidated financial statements	<input type="checkbox"/>	<input type="checkbox"/>	_____
5. Has the company disclosed in its Form 10-K or 10-KSB all changes in its internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the company’s internal control over financial reporting?	<input type="checkbox"/>	<input type="checkbox"/>	_____
a. If so, has the company made appropriate disclosure of information about the circumstances surrounding the change that are necessary to make the disclosure about the change to internal control not misleading?	<input type="checkbox"/>	<input type="checkbox"/>	_____

Describe all other internal control–related matters the company disclosed in its Form 10-K or 10-KSB.

PART II

Documentation of Internal Control Design

Work Program for the Review of Documentation of Entity-Level Controls

PURPOSE

This form has been designed to

- Document your overall approach to the review of internal control documentation of entity-level controls
- Document the work performed and conclusions reached regarding the adequacy of the company's documentation of entity-level controls

INSTRUCTIONS

The work program on form DOC-1b assumes that you have already performed steps 15 and 16 of the General Work Program or otherwise satisfied yourself as to

- *Documentation completeness.* Documentation exists for all entity-level controls included within the scope of the project.
- *Documentation currency.* The company's internal control documentation has been properly maintained to ensure that
 - All changes to entity-level policies and procedures have been reflected in the related documentation
 - Access to entity-level documentation has been controlled effectively and *only* authorized changes to the documentation have been made

Once you have established the completeness of the company's entity-level documentation and the continued integrity of the documentation that was prepared previously, your review of internal control documentation may be limited to the changes made since the last assessment of internal control.

Form DOC-1a allows you to summarize your overall approach to reviewing the company's entity-level control documentation, that is

- The procedures performed to establish the completeness and currency of the documentation
- The new documentation selected for review

Form DOC-1b is a series of worksheets that should be prepared for each entity-level group of controls selected for review. These worksheets correspond to the entity-level controls that are required to be included in the company’s assessment of internal control, as indicated on form ADM-2. All control deficiencies identified during your review should be carried forward to your summary of control deficiencies (e.g., form ADM-3).

Determining Whether the Documentation Is Adequate

Unlike the guidance for the documentation of activity-level controls, the requirements for documenting entity-level controls are much less definitive. In general, the documentation of entity-level controls should be sufficiently detailed and clear enough to

- Indicate that management has identified the significant elements of each entity-level control group that are necessary to create an environment that enables the effective functioning of activity-level controls
- Communicate effectively the policies and procedures throughout the organization
- Monitor the effective operation of controls
- Allow the project team to fulfill its responsibilities to
 - Evaluate the effectiveness of the design of the policy or procedure and
 - Design tests of operating effectiveness

Summary of Source Materials

Like any checklist, the checklist for reviewing the documentation of entity-level controls is a distillation of guidance provided elsewhere. For additional information and clarification of the items presented on these worksheets, you should refer to that guidance, which is summarized in the following table.

Entity-Level Control	Source for Additional Information
Control Environment	See Chapter 2 of the COSO Internal Control Integrated Framework.
Risk Assessment	See Chapter 3 of the COSO Internal Control Integrated Framework.
Monitoring	See Chapter 6 of the COSO Internal Control Integrated Framework.
Period-End Financial Reporting Process	See paragraph 76 of PCAOB Auditing Standard No. 2.
Selection and Application of Accounting Policies	<ul style="list-style-type: none">• AICPA Statement on Auditing Standards No. 61, <i>Communication with Audit Committees</i> (AICPA, <i>Professional Standards</i>, vol. 1, AU Section 380), particularly paragraph .07

Entity-Level Control	Source for Additional Information
	<ul style="list-style-type: none"> • Practice Issues Task Force Alert 2000-2, <i>Quality of Accounting Principles—Guidance for Discussions with Audit Committees</i>, item 3.7, nonauthoritative guidance provided by the SEC Practice Section of the AICPA • SEC release No. 33-8040, <i>Cautionary Advice Regarding Disclosure about Critical Accounting Policies</i>
Audit Committee Effectiveness	See paragraphs 57 and 58 of PCAOB Auditing Standard No. 2.
Antifraud Programs and Controls	See <i>Management Anti-Fraud Programs and Controls</i> . This document was published as an appendix to AICPA Statement on Auditing Standards No. 99. ¹
IT General Controls	See <i>IT Control Objectives for Sarbanes-Oxley</i> , published by the Information Technology Governance Institute in conjunction with the Information Systems Audit and Control Association. ²
Nonroutine Transactions	The guidance presented in this section is the suggestions of the author and not derived from other sources.

¹ This document is available as a free download at www.aicpa.org/antifraud/homepage.htm. From the “Select a Topic” menu, choose “Prevent Fraud” and you will be linked to a new page; select “Instituting Antifraud Programs and Controls” to link to the document.

² This document can be downloaded from either the ITGI Web site at www.itgi.org or the ISACA Web site at www.isaca.org.

Footnoted comments in italics are additional instructions to the preparer of the form and should be removed before the form is considered final.

Assessment of Internal Control Effectiveness

Overall Approach to Review of the Documentation of Entity-Level Controls

PURPOSE

This form has been designed to

- Document the procedures you performed to assess the completeness, currency, and content of entity-level controls
- Document the results of your review
- Describe the actions you took to correct identified entity-level control deficiencies

INSTRUCTIONS

In step 1 of the form you should describe the procedures you performed to determine that documentation exists for all entity-level controls included within the scope of the project. The matrix included on form ADM-2 may be helpful for this purpose.

In step 2 you should document the methods used by the company to maintain the integrity of its documentation of internal control design. For example, the company's electronic database of control descriptions may be protected by logical and physical access controls. You then should describe the procedures you performed to conclude that these controls were operating effectively throughout the year. Once you establish that the integrity of previously documented controls has been maintained, then you may rely on that documentation in the current period, assuming that the control policies and procedures remain the same.

In step 3 you should identify all changes to entity-level control policies and procedures made since the last assessment. You can now restrict your review of entity-level control documentation to those changed elements, which are documented in step 4.

In steps 5 and 6 you should document the findings of your review, whether any control deficiencies were noted, and if so, the corrective action taken.

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

SUMMARY OF INTERNAL CONTROL DOCUMENTATION

Paragraph 42 of PCAOB Auditing Standard No. 2 requires the company to document all five components of internal control over financial reporting. Our compliance with that requirement is summarized in this form, which focuses on entity-level controls, and form DOC-2, which summarizes the documentation of activity-level controls. The following table maps the COSO internal control components to these two forms.

Internal Control Component	Entity-Level (DOC-1)	Activity-Level (DOC-2)
Control environment	X	
Risk assessment	X	
Information		X
Communication	X	X
Control activities		X
Monitoring	X	

REVIEW OF DOCUMENTATION OF ENTITY-LEVEL CONTROLS

This form describes our overall approach for reviewing the documentation of entity-level controls.

1. *Documentation completeness.* We determined that the company’s documentation included all entity-level controls within the scope of the project by performing the following procedures.

2. *Maintenance of previously created documentation.* We reviewed the company’s method for ensuring the continued integrity of the documentation of entity-level controls in those instances where the company’s policies and procedures have remained unchanged since the last assessment of internal control effectiveness. The following summarizes these methods and their adequacy, which served as a basis for concluding

that a review of the documentation of unchanged policies and procedures was not necessary.

3. *Changes to internal control procedures.* We identified all changes to entity-level control policies and procedures that have been made since the last assessment of internal control and determined that these changes were properly reflected in the internal control documentation. The procedures we performed to achieve this objective are as follows.

4. *Entity-level controls selected for documentation review.* Our review of entity-level control documentation was limited to changes in that documentation that occurred since our last assessment of internal control effectiveness. We reviewed the documentation related to the following entity-level controls.

5. *Findings.* We noted the following control deficiencies during our review of entity-level control documentation.¹

6. *Corrective action.* As a result of the control deficiencies summarized in step 5, we took the following actions.

¹ *In addition to listing the control deficiencies, you also may want to indicate which deficiencies are considered significant deficiencies and which are material weaknesses.*

Assessment of Internal Control Effectiveness Checklist for the Review of the Documentation of Entity-Level Controls

PURPOSE

Use this form to

- Determine whether the company’s documentation of entity-level controls includes all relevant matters at an appropriate level of detail and clarity
- Document and assess the company’s methods for communicating entity-level control policies and procedures throughout the organization

INSTRUCTIONS

This form contains a series of worksheets that should be prepared for each entity-level group of controls selected for review. These worksheets correspond to the entity-level controls that are required to be included in the company’s assessment of internal control, as indicated on form ADM-2. All control deficiencies identified during your review should be carried forward to your summary of control deficiencies (e.g., form ADM-3).

Each worksheet provides a listing of the key elements that should be described by the relevant document. As you read each document, determine whether it contains the required element and mark the corresponding checkbox.

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

CONTROL ENVIRONMENT

	Yes	No	N/A	Ref.
Documentation Content Does the documentation include the following policies and procedures with sufficient clarity and detail so that they can be understood by all those who are affected by them?				
1. The company's values	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
2. Acceptable workplace behavior	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
3. Unacceptable workplace behavior	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
4. The responsibility of management to periodically review and, if necessary, modify policies relating to company values and workplace behavior	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
5. The responsibility of management to act in ways that are consistent with and reinforce stated policies	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
6. Management's responsibility to identify compensation policies or other incentives that may motivate unethical behavior by employees	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
7. Actions taken by management, if any, to mitigate the risks posed by policies or incentives identified as a result of item 6	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
8. The procedures to be followed by management or the board of directors when it becomes aware of <ul style="list-style-type: none"> a. Internal control deficiencies b. Overly aggressive or other accounting policies that are of poor quality 	<input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/>	
9. The company's organizational structure and lines of reporting	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
10. Management's responsibility to appropriately consider internal control and financial reporting risks when determining the organizational structure of the company	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

	Yes	No	N/A	Ref.
11. The process for allocating resources to employees/employee groups that are necessary to enable them to perform their assigned responsibilities. Resources include a. Budget/funding b. Personnel c. Training	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	
12. Policies for establishing adequate segregation of duties				
13. Human resource policies relating to the following matters a. Hiring b. Compensation c. Performance evaluations d. Terminations e. Responsibilities for adhering to ethical and behavioral policies f. Consequences of failing to adhere to ethical or behavioral standards	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	
14. Independence requirements for members of the board	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
15. Financial accounting and other expertise required of the board of directors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
16. Policies and procedures followed by the board of directors to a. Oversee the company's financial reporting process b. Participate in management's risk assessment process c. Monitor the effectiveness of internal control	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	

Communication

We reviewed the ways in which the company communicates its control environment–related policies throughout the organization. Our findings and conclusions are as follows.

RISK ASSESSMENT

	Yes	No	N/A	Ref.
Documentation Content				
Does the documentation include the following policies and procedures with sufficient clarity and detail so that they can be understood by all those who are affected by them?				
1. Management’s process for assessing risk, including				
a. The overall financial reporting objective of the publishing of reliable financial statements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
b. The identification of risks that may prevent the company from achieving its stated financial reporting objective	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
c. The analysis of risk for all key business processes where potential exposures of some consequence may exist	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
2. The mechanisms in place to identify changes that could create new risks to achieving stated financial reporting objectives. These changes include				
a. Changed operating environment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
b. New personnel	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
c. New or revamped information technology (IT) systems	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
d. Rapid growth	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
e. New lines, products, or business activities	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
f. Restructurings	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
g. Foreign operations	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
h. New accounting principles or other financial reporting requirements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

Communication

We reviewed the ways in which the company communicates its risk assessment policies and procedures to affected individuals and groups. Our findings and conclusions are as follows.

MONITORING

	Yes	No	N/A	Ref.
Documentation Content				
Does the documentation include the following policies and procedures with sufficient clarity and detail so that they can be understood by all those who are affected by them?				
1. Process for ensuring that <i>all</i> communications from external and internal parties relating to internal control effectiveness are considered by management	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
2. Policies and procedures for taking appropriate action with respect to identified control deficiencies	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
3. Policies and procedures regarding the comparison of amounts recorded by the accounting system with physical assets	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
4. Protocols for determining what information about internal control is needed at a particular time for decision making	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
5. Policies and procedures relating to whether personnel are asked periodically to state whether they understand and comply with the company's code of conduct and regularly perform critical control activities	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

Communication

We reviewed the ways in which the company communicates its internal control monitoring policies and procedures to affected individuals and groups. Our findings and conclusions are as follows.

PERIOD-END FINANCIAL REPORTING

	Yes	No	N/A	Ref.
Documentation Content				
Does the documentation include the following policies and procedures with sufficient clarity and detail so that they can be understood by all those who are affected by them?				
1. The procedures used to enter transaction totals into the general ledger	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
2. The procedures related to journal entries, including <ul style="list-style-type: none"> a. The initiation of journal entries b. The authorization of journal entries c. The recording of journal entries d. The processing of journal entries in the general ledger 	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	
3. Other procedures used to record recurring and nonrecurring adjustments to the annual and quarterly financial statements, for example <ul style="list-style-type: none"> • Consolidating adjustments • Report combinations • Classifications 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
4. Procedures for drafting <ul style="list-style-type: none"> a. Financial statements b. Related disclosures 	<input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/>	
<i>Developing Significant Accounting Estimates</i>				
5. The significant estimates required to prepare the company's financial statements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
6. Procedures for communicating the need for proper accounting estimates	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
7. Procedures for accumulating relevant, sufficient, and reliable data on which to base the accounting estimate	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
8. Procedures for the preparation of the estimate, including <ul style="list-style-type: none"> a. Who is responsible for preparing the estimate b. When the estimate is to be prepared 	<input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/>	

	Yes	No	N/A	Ref.
9. Procedures for the review and approval of the estimate, including				
a. Review of sources of relevant factors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
b. Review of development of assumptions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
c. Review of reasonableness of assumptions and resulting estimates	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
d. Consideration of the need to use the work of specialists	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
e. Consideration of changes in previously established methods to arrive at accounting estimates	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
10. Policies relating to the comparison of prior accounting estimates with subsequent results to assess the reliability of the process used to develop estimates	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
11. The responsibility of management to consider whether the final accounting estimate is consistent with the operational plans of the entity	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

Communication

We reviewed the ways in which the company communicates its period-end financial reporting policies and procedures to affected individuals and groups. Our findings and conclusions are as follows.

SELECTION AND APPLICATION OF ACCOUNTING POLICIES

	Yes	No	N/A	Ref.
Documentation Content				
Does the documentation include the following policies and procedures with sufficient clarity and detail so that they can be understood by all those who are affected by them?				

	Yes	No	N/A	Ref.
1. Informing the audit committee of the initial selection of and subsequent changes to significant accounting policies or their application a. The initial selection and application of significant accounting policies b. Subsequent changes to significant accounting policies c. Subsequent changes to the application of significant accounting policies	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	
2. Informing the audit committee about the methods used to account for significant unusual transactions, which may include <ul style="list-style-type: none"> • Bill-and-hold transactions • Self-insurance • Multielement arrangements contemporaneously negotiated • Sales of assets or licensing arrangements with continuing involvement of the enterprise 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
3. Informing the audit committee about the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative accounting guidance or consensus, for example <ul style="list-style-type: none"> • Revenue recognition • Off-balance-sheet financing • Accounting for equity investments • Research and development activities • Special-purpose financing structures that affect ownership rights (such as leveraged recapitalizations, joint ventures, and preferred stock subsidiaries) 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

Communication

We reviewed the ways in which the company communicates its policies and procedures for the selection and application of significant accounting policies to affected individuals and groups. Our findings and conclusions are as follows.

AUDIT COMMITTEE OVERSIGHT

	Yes	No	N/A	Ref.
Documentation Content				
Does the documentation include the following policies and procedures with sufficient clarity and detail so that they can be understood by all those who are affected by them?				
1. Policies and procedures related to the independence of the audit committee members	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
2. Audit committee responsibilities	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
3. Policies relating to the committee's involvement with and interaction with				
a. External auditors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
b. Internal auditors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
c. Key members of financial management	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
4. Actions taken by the committee to understand and respond to significant internal control or financial reporting matters such as	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Critical accounting policies				
• Significant accounting estimates				
• Control deficiencies				
• Other matters raised by the auditor				

Communication

We reviewed the ways in which the company communicates its policies and procedures related to the audit committee to affected individuals and groups. Our findings and conclusions are as follows.

ANTIFRAUD PROGRAMS AND CONTROLS

	Yes	No	N/A	Ref.
Documentation Content				
Does the documentation include the following policies and procedures with sufficient clarity and detail so that they can be understood by all those who are affected by them?				
<p>1. Policies and procedures designed to create a culture of honesty and high ethics. These policies and procedures may address issues such as</p> <ul style="list-style-type: none"> • The articulation of company values founded on integrity • The creation of a positive workplace environment in which employees have positive feelings about the entity • Human resource policies that minimize the chance of hiring or promoting individuals with low levels of honesty, especially in positions of trust • Training—both at the time of hire and on an ongoing basis—about the entity's values and its code of conduct • Confirmation from employees that they understand and have complied with the entity's code of conduct and that they are not aware of any violations of the code • Appropriate investigation and response to incidents of alleged or suspected fraud 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
<p>2. Policies and procedures relating to management's evaluation of fraud risk and the company's antifraud processes and controls. Such policies and procedures may address</p> <ul style="list-style-type: none"> • The identification and measuring of fraud risk • The steps taken to mitigate identified risks • The implementation and monitoring of appropriate preventive and detective controls • Other fraud deterrent measures 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
<p>3. Policies and procedures related to the audit committee's active oversight of the company's antifraud processes and controls</p>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

Communication

We reviewed the ways in which the company communicates its antifraud policies and procedures to affected individuals and groups. Our findings and conclusions are as follows.

IT GENERAL CONTROLS

	Yes	No	N/A	Ref.
Documentation Content				
Does the documentation include the following policies and procedures with sufficient clarity and detail so that they can be understood by all those who are affected by them?				
Plan and Organize				
1. An overall IT strategic plan	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
2. Information architecture, including issues such as <ul style="list-style-type: none">Controls relating to the capture, processing, and reporting of informationSecurity policiesPrivacy policies	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
3. Policies and procedures that define the IT organization and relationships. These policies and procedures might address issues such as <ul style="list-style-type: none">The identification of key systems and dataRoles and responsibilities of IT personnelThe periodic evaluation of IT personnel	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
4. Policies and procedures that ensure compliance with external reporting requirements that address issues such as <ul style="list-style-type: none">The identification of changes to external reporting requirements that require IT changes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

	Yes	No	N/A	Ref.
<ul style="list-style-type: none"> • The identification of internal events that affect reporting requirements 				
5. Risk assessment policies and procedures that address issues such as <ul style="list-style-type: none"> • Technology reliability • Information integrity • IT personnel • Security assessments for all significant systems and locations 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
6. Policies and procedures that ensure quality, for example <ul style="list-style-type: none"> • IT systems documentation standards • Data integrity, ownership, and responsibilities 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
<i>Acquire and Implement</i>				
7. Software acquisition and implementation policies and procedures, which address issues such as <ul style="list-style-type: none"> • The systems development life cycle • The acquisition of software • The installation of new and modified software 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
8. Hardware acquisition and implementation policies and procedures, which address issues such as <ul style="list-style-type: none"> • Acquisition • Implementation • Maintenance 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
9. User reference and support manuals or other documentation that helps ensure the long-term sustainability of the system	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
10. Testing procedures for new or modified systems, including <ol style="list-style-type: none"> a. Unit, system, integration, and user acceptance b. Load and stress testing c. Interfaces with other systems d. Data conversion 	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> 	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> 	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> 	

	Yes	No	N/A	Ref.
11. Change management policies and procedures that address issues such as <ul style="list-style-type: none"> • The override of established procedures, for example, in an emergency situation • Plans for the timely change to systems and applications 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
<i>Delivery and Support</i>				
12. Policies and procedures relating to the use of third-party service providers, which may include <ul style="list-style-type: none"> • Vendor policies for selection of outsourced services • Key performance indicators for managing service-level agreements • Selection process for third-party service providers • Third-party service contracts • Policies and procedures for monitoring third-party service levels, including reviews of security, availability, and processing integrity 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
13. Policies and procedures for monitoring the performance and capacity levels of the IT systems and, if measures are less than optimal, taking appropriate action	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
14. A business continuity plan that may include policies and procedures for <ul style="list-style-type: none"> • Testing the plan • Updating the plan • Testing offsite storage and recovery facilities • System recovery procedures necessary to ensure the timely reporting of financial information 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
15. System security policies and procedures, which address issues such as <ul style="list-style-type: none"> • The development, updating, and maintenance of a security plan • Methods used to authenticate users to the system • Maintaining the effectiveness of authentication and access mechanisms 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

	Yes	No	N/A	Ref.
<ul style="list-style-type: none"> • The requesting, establishing, issuing, suspending, and closing of user accounts • The prevention of unauthorized access to the network • The performance of security assessments • The monitoring of security activity and security violations 				
16. Policies and procedures related to the education and training of all personnel using IT services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
17. Configuration management policies and procedures that address issues such as <ul style="list-style-type: none"> • Software that is authorized for use by employees • The configuration of system infrastructure • The configuration of application software • The configuration of data storage • Mitigation of risks posed by computer viruses • Testing software and network infrastructure to ensure it is properly configured 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
18. Policies and procedures relating to the management of problems and incidents, which may address issues such as <ul style="list-style-type: none"> • Operational events that are not part of the standard operation • Emergency program changes • Methods used to trace from the operational incident to its underlying cause 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
19. Data management policies and procedures that address issues such as <ul style="list-style-type: none"> • Data processing controls, including those related to <ul style="list-style-type: none"> - The completeness of transaction processing - The accuracy of transaction processing - The authorization of transactions - The validity of transactions • Controls over data input • The handling, distribution, and retention of data and reporting output • The protection of sensitive information during its storage and transmission 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

	Yes	No	N/A	Ref.
<ul style="list-style-type: none"> • The retention and storage of <ul style="list-style-type: none"> - Data - Programs - Reports - Documentation • Physical security and accountability for data • Changes in data structures 				
20. Facilities management policies and procedures, such as <ul style="list-style-type: none"> • Controlled access to facilities • Environmental controls at physical facilities 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
21. IT operations management policies and procedures, including those that address issues such as <ul style="list-style-type: none"> • Standard procedures for IT operations • Processing continuity during operator shift changes • Metrics used to manage daily activities of the IT department • The retention of system event data that allows for the reconstruction, review, and examination of the time sequences of processing 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
<i>Monitoring</i>				
22. Policies and procedures related to the monitoring of IT processes that address issues such as <ul style="list-style-type: none"> • Benchmarks used to monitor IT processes • The processes used to identify IT weaknesses and take appropriate action • The ongoing monitoring of IT controls and the reporting of deficiencies to senior management • The periodic monitoring of IT services and activities by an independent individual(s) 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

Communication

We reviewed the ways in which the company communicates its IT general control policies and procedures to affected individuals and groups. Our findings and conclusions are as follows.

NONROUTINE TRANSACTIONS

	Yes	No	N/A	Ref.
Documentation Content				
Does the documentation include the following policies and procedures with sufficient clarity and detail?				
1. The nature of the transaction, including the terms that were most significant in determining the accounting treatment for the transaction	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
2. The counterparty(ies) to the transaction	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
3. The business reason for entering into the transaction	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
4. The process followed by the company to authorize the transaction and its accounting treatment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
5. How the transaction was accounted for and disclosed in the financial statements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

Communication

We reviewed the ways in which the company communicates its policies and procedures related to nonroutine transactions to affected individuals and groups. Our findings and conclusions are as follows.

Work Program for the Review of Documentation of Activity-Level Controls

PURPOSE

This form has been designed to

- Document your overall approach to the review of internal control documentation of activity-level controls
- Document the work performed and conclusions reached regarding the adequacy of the company's documentation of activity-level controls

INSTRUCTIONS

The work program on form DOC-2b assumes that you have already performed steps 15 and 16 of the General Work Program or otherwise satisfied yourself as to

- *Documentation completeness.* Documentation exists for all significant processes, business units, or locations to be included within the scope of the project.
- *Documentation currency.* The company's internal control documentation has been properly maintained to ensure that
 - All changes to internal control procedures at the company have been reflected in its internal control documentation
 - Access to the documentation database has been controlled effectively and *only* authorized changes to the documentation have been made

Once you have established the completeness of the company's documentation and the continued integrity of the documentation that was prepared previously, your review of the internal control documentation may be limited to the changes made since the last assessment of internal control.

Form DOC-2a allows you to summarize your overall approach to reviewing the company's internal control documentation, that is

- The procedures performed to establish the completeness and currency of the documentation
- The new documentation selected for review, and if only a sample of the new documentation was reviewed, how you determined that sampling was appropriate and how you selected the items for review

Form DOC-2b is a worksheet that should be prepared for each significant process or business unit/location selected for review. All control deficiencies identified during your review should be carried forward to your summary of control deficiencies (e.g., form ADM-3). Note that this form includes *only* the consideration of routine transactions. Nonroutine transactions and accounting estimates are considered as part of the review of entity-level controls.

Footnoted comments in italics are additional instructions to the preparer of the form and should be removed before the form is considered final.

Assessment of Internal Control Effectiveness: Overall Approach to Review of the Documentation of Activity-Level Controls

PURPOSE

This form has been designed to

- Document the procedures you performed to assess the completeness, currency, and content of activity-level controls
- Document the results of your review
- Describe the actions you took to correct identified activity-level control deficiencies

INSTRUCTIONS

In step 1 of the form you should describe the procedures you performed to determine that documentation exists for all activity-level controls included within the scope of the project.

In step 2 you should document the methods used by the company to maintain the integrity of its documentation of internal control design. For example, the company's electronic database of control descriptions may be protected by logical and physical access controls. You then should describe the procedures you performed to conclude that these controls were operating effectively throughout the year. Once you establish that the integrity of previously documented controls has been maintained, then you may rely on that documentation in the current period, assuming that the control policies and procedures remain the same.

In step 3 you should identify all changes to activity-level control policies and procedures made since the last assessment. You can now restrict your review of activity-level control documentation to those changed elements, which are documented in step 4.

In steps 5 and 6 you should document the findings of your review, whether any control deficiencies were noted, and if so, the corrective action taken.

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

This form describes our overall approach for reviewing the internal control documentation of significant routine transactions and related controls. (The review of the documentation

of controls relating to nonroutine transactions and accounting estimates was performed in conjunction with our review of entity-level controls, as documented on form DOC-1.)

- 1. *Documentation completeness.* We determined that the company’s internal control documentation encompasses all significant transactions and business units/locations by performing the following procedures.

- 2. *Maintenance of previously created documentation.* We reviewed the company’s method for ensuring the continued integrity of the documentation of internal control in those instances where the company’s control procedures have remained unchanged since the last assessment of internal control effectiveness. The following summarizes these methods and their adequacy, which served as a basis for concluding that a review of the documentation of unchanged controls was not necessary.

- 3. *Changes to internal control procedures.* We identified all changes to business processes and internal control procedures that have been made since the last assessment of internal control and determined that these changes were properly reflected in the internal control documentation. The procedures we performed to achieve this objective are as follows.

4. *Processes selected for review.* Our review of internal control documentation was limited to changes in that documentation that occurred since our last assessment of internal control effectiveness. We reviewed the following significant transactions and business units/locations.

5. *Findings.* We noted the following control deficiencies during our review of internal control documentation.¹

6. *Corrective Action.* As a result of the control deficiencies summarized in step 5, we took the following actions.

¹ In addition to listing the control deficiencies, you also may want to indicate which deficiencies are considered significant deficiencies and which are material weaknesses.

Assessment of Internal Control Effectiveness: Checklist for the Review of the Documentation of a Significant Transaction or Business Unit/Location

PURPOSE

Use this form to

- Determine whether the company's documentation of activity-level controls includes all relevant matters at an appropriate level of detail and clarity
- Document and assess the company's methods for communicating activity-level control policies and procedures throughout the organization

INSTRUCTIONS

This form should be completed for each significant transaction or the significant accounts of individually important business units/locations included within the scope of the project. All control deficiencies identified during your review should be carried forward to your summary of control deficiencies (e.g., form ADM-3).

The form provides a listing of the key elements that should be described by the relevant document. As you read the documentation pertaining to the transaction or business unit, determine whether the documentation contains the required element and mark the corresponding checkbox.

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

Transaction or Business Unit: _____

	Yes	No	N/A
Documentation Content			
Does the documentation include the following elements?			
1. A description of the control procedure that is sufficiently detailed to allow an employee to understand and apply the procedure	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. An indication of the following items to which the control procedure relates			
a. The control objective	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. The financial statement account or disclosure	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. The relevant assertion(s)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. The person responsible for performing the control procedure	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. How frequently the procedure is to be performed	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Whether and how the performance of the procedure is documented (or other information that will allow for the performance of tests to determine that the control procedure was performed properly)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. Information about how the significant transaction is			
a. Initiated	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Authorized	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Recorded	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Processed	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. Reported	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Sufficient information about the flow of transactions to identify the points at which material misstatements due to error or fraud could occur	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<i>Communication</i>			
8. Has the control procedure been communicated to the person responsible for its performance?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<i>Ongoing Monitoring</i>			
9. Has an individual at an appropriate level of authority been assigned to periodically review the ongoing performance of the control procedure?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Documentation Techniques and Selected Examples for Routine Transactions

PURPOSE

Use this form to help you design internal control documentation. Design techniques include flowcharts, narratives, and matrixes.

INSTRUCTIONS

This form provides only examples and guidance. It is not necessary to complete any section of this form or to include it in your documentation of internal control or the internal control assessment.

HOW TO DESIGN INTERNAL CONTROL DOCUMENTATION

The way in which you document your company's routine transactions is entirely up to you. The only requirement is that the documentation meet the following objectives.

- The documentation of controls contains all the elements required by paragraph 42 of PCAOB Auditing Standard No. 2 (see form DOC-2b).
- The documentation of controls is sufficiently detailed and clear to allow
 - Those affected by the procedure to understand it and either perform the procedure or monitor its performance
 - The project team to (1) assess design effectiveness and (2) design tests of operating effectiveness

Designing a documentation architecture that meets these two objectives will allow you to meet your compliance obligations. However, you may decide to go beyond mere compliance.

Documentation—though not one of the COSO components—is an integral part of the internal control structure. High-quality documentation enables the effective communication of prescribed control procedures across the organization and over time. Documentation allows for the consistent performance and monitoring of controls, which allows internal control to be institutionalized, become part of a *system*, and be less reliant on the competency and diligence of individual employees. As you design your control documentation, consider whether it is capable of achieving these broader objectives.

There are three basic documentation techniques:

- Flowcharts
- Narratives
- Matrixes

Each technique has its relative strengths and weaknesses. Typically, a combination of two or all three techniques is used to document a given transaction or business process. Occasionally, for example, to document one of the company's less significant transactions, one technique may suffice.

The process followed to design internal control documentation typically involves the following steps.

1. Decide on objective(s) for the documentation. For example, is the documentation being prepared solely for the project team to comply with the requirements of the internal control assessment? Or do you want the documentation to be distributed widely at the company to communicate control procedures and responsibilities?
2. Determine the content necessary to achieve your objective.
3. Decide which documentation techniques are best suited to communicate your content and serve either necessary function (see below).
4. Design individual documents and overall document architecture. Regardless of which documentation technique you use, you will need to design individual documents or set basic guidelines for their creation. You also should determine how the individual documents relate to each other—that is, the overall documentation architecture. This design of individual documents and overall architecture is a fluid process in which the design of one will affect the design of the other.

Functional Considerations in Structuring a Documentation Architecture

When designing your documentation of internal control, consider the following functional features that should be included.

- *Maintainability.* Your documentation should facilitate easy updating and maintenance as business processes and controls change over time.
- *Ease of review.* The documentation of internal control should be designed in a user-friendly fashion. For compliance purposes, the project team and the external auditors are the primary users, and so the documentation should allow for these individuals to
 - Easily assess the effectiveness of the design of internal control
 - Facilitate the design of tests of controls
- *Information gathering.* To create new or update existing documentation will require people to gather information about the company's business processes and controls. Your documentation methods should recognize this need and, to the extent possible, make it easy to gather and input the information required to create appropriate documentation.

- *Scalability.* Your documentation techniques should be equally adept at handling processes with many control points and those with only a few.

In addition to the preceding, which are the minimum features you should consider for complying with the requirement to document internal control, you also may consider the following *optional* features.

- Whether your documentation allows individual employees to easily understand their responsibilities and to facilitate the communication of business processes and controls and roles and responsibilities throughout the organization

Documentation Content Considerations

Paragraph 42 of PCAOB Auditing Standard No. 2 requires the following information to be included in your documentation of routine transactions.

- The design of controls over all relevant assertions related to all significant accounts and disclosures in the financial statements. The documentation should include the five components of internal control over financial reporting.
- Information about how significant transactions are initiated, authorized, recorded, processed, and reported.
- Sufficient information about the flow of transactions to identify the points at which material misstatements due to error or fraud could occur.
- Controls designed to prevent or detect fraud, including who performs the controls and the related segregation of duties.

In addition to the required content elements, you may find that documenting the following information will help improve the overall effectiveness of the company's internal control documentation architecture.

- *Labels for control procedures, control objectives, or other information.* By assigning a unique label to information (e.g., one control procedure may be labeled "C-1" another "C-2", etc.), you allow for the easy linking or cross-referencing between individual documents.
- *Links to tests of operating effectiveness.* When evaluating the results of tests of controls, you should consider the control objective that the control procedure was designed to achieve. Providing that link in your documentation of internal control will facilitate the effective review of test results.
- *Links to overall conclusion on design effectiveness.* This evaluation typically is done for the transaction or business process as a whole and not for individual control procedures.
- *Date prepared or modified, date reviewed, and by whom.* This information will help assess the currency or continued accuracy of the documentation.

FLOWCHARTING

Flowcharting allows you to describe graphically the overall information processing stream for a transaction or groups of transactions. Markers on the flowchart may then be used to

indicate the point in the stream where control procedures are performed and to reference a description of the control procedure itself. Flowcharts may be embedded within a narrative to provide the reader with a high-level, more general depiction of the details described in the narrative.

Strengths and Weaknesses

STRENGTHS OF FLOWCHARTING AS A DOCUMENTATION METHOD FOR ROUTINE ACTIVITY-LEVEL CONTROLS

- It is easy to recognize the point in the processing stream at which errors could be introduced and control procedures should be located. This information aids in evaluating design effectiveness and determining which controls should be tested.
- It is highly effective at capturing the overall flow of information.
- For visual-based learners, flowcharts are the most effective means of communicating information about information processes and controls.
- It is a scalable and highly flexible format.

WEAKNESSES OF FLOWCHARTING AS A DOCUMENTATION METHOD FOR ROUTINE ACTIVITY-LEVEL CONTROLS

- By itself, it is not capable of capturing all required documentation elements or the necessary detailed description of control procedures. It must be supplemented with other types of documentation.

Tips for Flowcharting¹

FOLLOW THE FLOW OF INFORMATION

Accounting manuals and other traditional means of documenting accounting processes frequently focus on the flow of documents through the system. For example, if a four-part receiving form is completed to document the receipt of raw materials, one approach to documentation would be to track the processing and eventual disposition of each of the four copies of the form. For the purpose of understanding activity-level controls, it usually is more effective to track the flow of *information* rather than the flow of documents. By tracking the flow of information, you are better able to identify the processes that change that information. Whenever information is changed, the risk of error enters the system, and that risk must be controlled.

To focus on the flow of information, you should consider working *backwards*, beginning with the posting to the general ledger. Obtain answers to a series of questions that seek to determine what *information* is created throughout the process and *how it is processed*. For example:

¹ A slightly different version of this section originally appeared in How to Comply with Sarbanes-Oxley Section 404, by Michael Ramos, published by John Wiley and Sons, 2004.

What is posted as a debit to inventory and a credit to accounts payable?

Monthly purchases.

How is this information created?

It is an accumulation of individual transactions throughout the month.

How is the information related to individual transactions created?

Invoices are matched with receiving reports and purchase orders and entered into the system on a real-time basis.

In this short example, you have quickly determined how information is created and processed, from initiation through posting. The fact that one copy of the purchase order is sent to the vendor or that production managers receive updates on raw material receipts is not considered.

DEFINE THE BOUNDARIES OF THE SYSTEM

Accounting systems have limits, and it is important that you clearly define them. The entity's control procedures start at the perimeter of its accounting system.

For example, an entity's purchase of raw materials may begin when the entity orders raw materials. The process continues through the vendor's selection, packing, and shipment of the product. Ultimately, the entity receives the materials it ordered.

In this scenario, the entity's controls begin when it receives the goods. It would be unreasonable to extend the control system any further upstream, for example, to the vendor's procedures for selecting and packing the materials.

For our purposes, the boundary of the activity-level accounting system is defined as the point at which the transaction information is approved and authorized and is in a format that is usable for accounting purposes (i.e., allows for the posting of debits and credits).

This definition of the accounting system boundary has several important implications. As a gatekeeper to the system, the system boundary must include control policies and procedures to ensure that

- Only valid, authorized transactions are allowed to enter the processing stream
- *All* valid, authorized transactions are captured for processing
- The accounting information that is captured accurately reflects the terms of the transaction

Your documentation of the activity-level controls should include a description of the control policies and procedures that meet these boundary control objectives.

TRANSACTIONS VERSUS EVENTS

Accounting information can be generated from either transactions or events. So far we have discussed the control implications related to business transactions, for example, the

purchase of raw materials. But what about the recording of depreciation expense? The process of calculating and posting depreciation expense is initiated not from a transaction with an external party, but rather with an event—namely, the passage of time.

Like transactions, events occur at the perimeter of the accounting system. The gatekeeper control objectives relating to events are the same as those relating to transactions. However, the way in which those objectives are achieved usually varies.

At the boundary, *transactions* usually are controlled in real time, on a transaction-by-transaction basis. Proper authorization of each transaction is critical. *Events* can be triggered merely by the passage of time. For example, the recording of depreciation expense is initiated by the arrival of the end of the month. Authorization of each individual event is not as critical. The processing of the event may be initiated by the system itself. The control procedures usually are performed after the fact, not at the time the event is processed. For example, the controller may scan the general ledger to ensure that depreciation expense was recorded once and only once.

PREVENTIVE VERSUS DETECTIVE CONTROLS

Controls can be designed to either

- Identify errors as they occur and prevent them from further processing
- Detect and correct errors that already have entered the system

There are trade-offs for each approach. *Preventive* controls are more timely and help ensure that errors are never recorded in the accounting records to begin with. However, to design and perform preventive controls at each step in the processing stream may be costly. *Detective* controls may be cheaper to design and perform. For example, performing a reconciliation once a month between the general ledger and a subsidiary ledger may be more efficient than performing preventive controls on each transaction at each step in the process. However, the drawback to detective controls is that they are performed after the fact, sometimes well after the fact. The lack of timely performance of a detective control could mean that errors remain in the accounting records for extended periods of time. Most systems rely on a combination of preventive and detective controls, and it is common to build some redundancy into the system, in which more than one control meets the same objective.

Preventive and detective controls have one important thing in common. Both types of controls contain both an error detection and a correction component. The fact that a control procedure can identify an error does not make the control effective. It is the process of communicating identified errors to individuals who can then make corrections that makes the control complete.

INFORMATION STORAGE AND RETRIEVAL

It is common for systems to capture data, store it, and then retrieve it for later use. For example, an entity may maintain a database of approved vendors. This database is updated regularly as vendors are added or removed. When the time comes to authorize a payment, the control procedure requires someone to access the database and determine whether the vendor has been approved. If the vendor is in the database, then payment is authorized; if not, then the matter is brought to someone of appropriate authority to take follow-up action.

Databases and other types of information storage repositories should be considered part of the activity-level processing stream and therefore protected by the control boundary. All of the boundary control objectives should be addressed for gaining access to the information storage repository. In this example, controls should exist to ensure that

- All approved vendors are in the database
- No unapproved vendors are in the database
- Only authorized users have the ability to access and modify the information maintained in the database

COMPUTER APPLICATION CONTROLS

Many control procedures are programmed into the entity's computer system. For example, the process of matching a vendor to a database of preapproved vendors may be completely computerized. A user may submit an invoice for payment, the computer performs the match, and, if the vendor is on the list, processing is allowed to continue. The user is informed only when the computer detects an error, namely, that the vendor has not been preapproved. It is then the user's responsibility to take the appropriate follow-up action. Again, the follow-up of the identified errors is a critical component of the control.

Ultimately, the effectiveness of computer application controls will depend on the effectiveness of relevant computer general controls, including

- *Systems development.* The application was properly developed and tested to make sure that the control functions as designed.
- *Access.* Access to the program is monitored to ensure that unauthorized changes to the program cannot be made.

The control objectives for computer application controls are the same as the objectives for manual controls—information must remain complete and accurate at all phases, from initiation (data input) through processing.

Example Flowchart

BACKGROUND INFORMATION

The example company is a real estate investment trust (REIT) that is involved in the acquisition, ownership, management, and leasing of shopping malls. The company's revenue stream has two different components: base rent (i.e., the minimum, fixed monthly rental paid by tenants) and percentage rent (i.e., additional rent calculated as a percentage of the tenant's gross sales).

Base Rent

Leases are negotiated at the local, property manager level, under broad guidelines provided by the corporate entity. Leases must be approved at the corporate level before they become final. A lease abstract is used to capture leasing information, and this information is entered into a database that is maintained at the property level. Monthly, the system runs

reports showing all changes to the lease information database, and these reports are reviewed by the property managers to ensure that all information was captured properly.

Monthly billing for base rent is handled locally and is totally automated. The billing application program accesses the database and prepares the monthly rent statements for the tenants. The program updates the rent receivable subledger. It also prepares a report that provides information on each space in the mall, including

- Tenant name
- Lease information summary, including base rent, scheduled rent adjustments, rent concessions, and the like
- Current month and prior month base rent

The property manager uses this report to check to see that all tenants got billed and at the right amount.

Cash receipts are physically received in the property manager's office. The process for capturing and reporting the information is largely manual.

- A receipt is prepared for each tenant.
- The receipts are batched and periodically input into the accounting system.
- The system processes the information by updating the accounts receivable ledger and posting a debit to cash.

At month end, the bank account is reconciled. The property manager reviews a print-out of the accounts receivable subledger to identify large, unexpected receivables balances that may indicate that a rent payment was not processed properly. The accounts receivable subledger is reconciled to the general ledger account on a monthly basis.

Percentage Rent

Most tenants are required to pay additional rent based on an agreed-upon percentage of gross sales. This percentage rent is paid quarterly.

Quarterly, each tenant submits a report that shows gross sales, the percentage rent, and the total amount due. A check for the amount due usually is provided at the same time. The percentage rent reports are entered into the system. The program performs two checks on the data:

1. It compares reported quarterly gross sales to the comparable period for each of the last two years and calculates percentage changes in the reported amounts. It then prepares a report of this analysis for review by the property manager.
2. It compares the percentage used to calculate the amount due to the percentages maintained in the property management database. Any differences are identified and reported on an exception report.

Month-End Reporting

Each mall prepares a standardized month-end reporting package, which it then submits to the corporate accounting office. The process for combining these reports at the corporate level is not yet fully automated. Some manual processing still is required to enter information

into the system for updating the corporate accounting records. Clerical-level staff performs the input. In addition to updating the accounting records, the system also provides a number of operating reports that provide both financial and nonfinancial data. These reports group the malls by geographic region. The asset manager for each region reviews these reports for anomalies and possible errors by comparing rental income and cash flow to budget and looking for large, unusual accounts receivable balances.

Internal Audit Activities

Internal auditors perform two important control activities at the property management level:

- 1. Compare lease information maintained in the property management database to signed lease agreements
- 2. “Audit” percentage rent reports by comparing gross sales information reported to the landlord to the sales records maintained by the client

DOCUMENTATION

The documentation of this system consists of two elements: a flowchart and an accompanying description of the related controls.

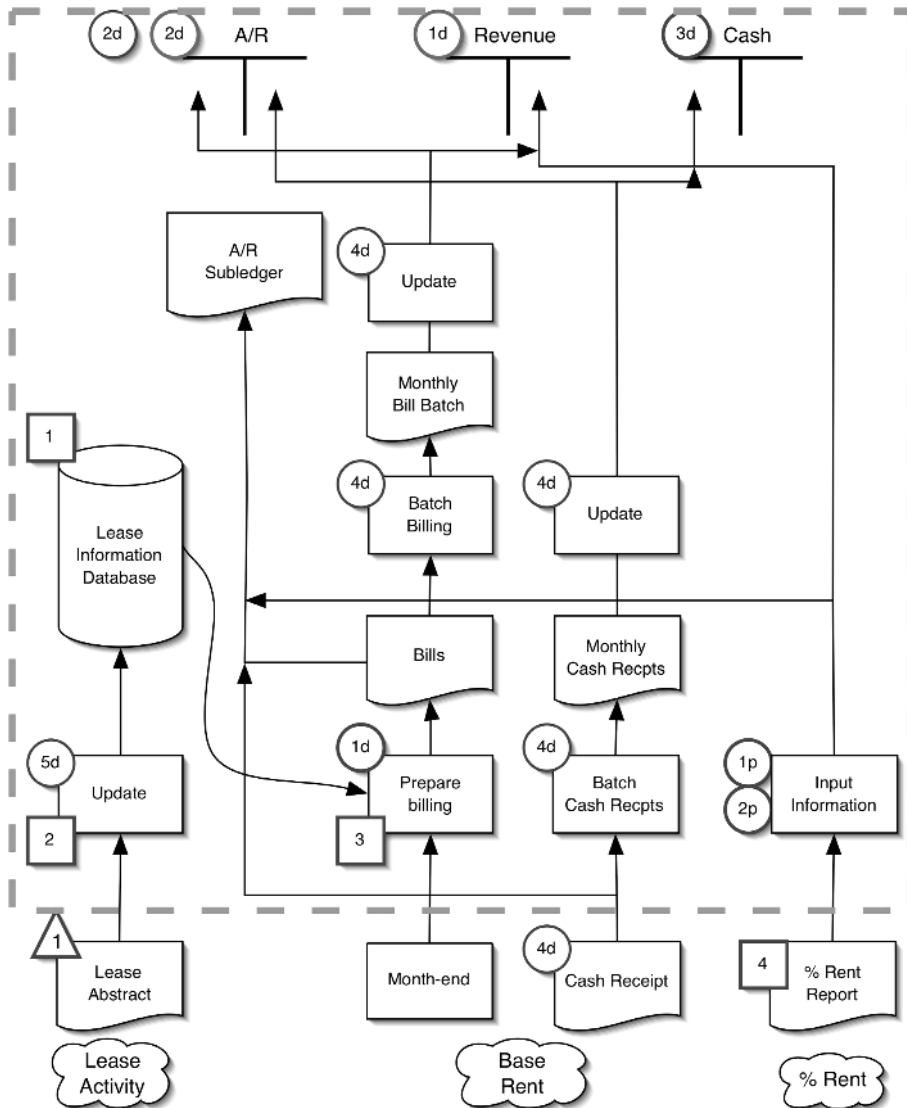
EXAMPLE COMPANY LEASING REVENUE DESCRIPTION OF CONTROLS

Ref. No.	Description
Entity-Level Controls	
1	The entity maintains access control software to monitor and limit unauthorized access to the database of lease information.
2	Internal auditors periodically compare the lease information in the database to signed lease agreements.
3	Month-end base rent calculations are performed automatically by the computer system. Systems development and program change controls ensure that the program functions properly. Access to the program is controlled to protect against unauthorized changes.
4	Periodically, internal auditors audit percentage rent reports by comparing gross sales information to tenant records.
Authorization Controls	
1	New leases and lease modifications and changes are reviewed, authorized, and approved by asset managers at the corporate level.

Ref. No.	Description
Activity-Level Controls	
1d	The property manager reviews a month-end report to ensure that all tenants got billed at their proper amount.
2d	The property manager reviews month-end receivables to identify unexpected balances.
3d	The bank account is reconciled monthly.
4d	The accounts receivable general ledger account is reconciled to the subsidiary ledger on a monthly basis.
5d	Monthly, the property manager reviews the changes made to the lease information database.
1p	Computerized controls compare quarterly sales to historical activity. Monthly, the property manager reviews reports to identify possible errors in the reporting of percentage rent.
2p	The percentage used by the tenant to calculate percentage rent is compared to the lease information database. Control is computerized—all exceptions are printed to a report for follow-up by a property management accountant on a monthly basis.

UNDERSTANDING THE FLOWCHART

- *Organization.* At the top of the flowchart are T-accounts, which represent the general ledger accounts affected by revenue transactions. At the bottom of the chart is the initiation of the transactions. In between the general ledger and the initiation are the various information processing steps.
- *Controls and processes.* Processes manipulate data. When data is changed, errors can occur. For example, one of the processes described on the flowchart is the batching of individual base-rent bills. In this process, it is possible that some individual bills could inadvertently be left out of the batch. Thus, each process should have related controls to ensure that the integrity of the information (i.e., its completeness and accuracy) is maintained during processing.
- *Referencing control descriptions.* This flowchart has identified four different types of controls.
 1. Authorization controls, which are designed to ensure that only valid, authorized transactions are entered into the processing stream.
 2. Entity-level controls.
 3. Activity-level controls, which may be either preventive or detective.
 4. Corporate controls, which are controls performed at the corporate level, not the property management level. By their nature, these are detective controls.



- *Information repository.* This system includes an information repository, which is the database of lease information. This database is used to prepare billings and possibly other information used to monitor activities. As described in this chapter, the information repository should reside within the boundary of the system and be protected from unauthorized access and changes.

NARRATIVES

A narrative is simply a description of the information processing steps and related controls. Typically, this information is presented as a linear text, although it is possible to include nontext elements (e.g., multimedia files, flowcharts) or to construct an overall documentation architecture that is nonlinear.

Strengths and Weaknesses

STRENGTHS OF NARRATIVES AS A DOCUMENTATION METHOD FOR ROUTINE ACTIVITY-LEVEL CONTROLS

- On one hand, this is the most flexible of the primary documentation methods. The overall structure of the narrative can serve a variety of primary objectives. For example, it can be organized to trace the flow of transactions or track the relationship of risks to control objectives.
- For text-based learners, narratives are a highly effective means of communicating information about processing streams and controls.
- Well-written narratives about how information is processed and controlled will provide a natural lead-in to a discussion of your assessment of the overall design effectiveness of the system.

WEAKNESSES OF NARRATIVES AS A DOCUMENTATION METHOD FOR ROUTINE ACTIVITY-LEVEL CONTROLS

- On the other hand, narratives can be relatively *inflexible* and rigid. Once the organizational scheme of a narrative is set, it is difficult to reengineer that scheme to achieve a different purpose. For example, a narrative written to help the external auditors evaluate control design effectiveness may not be useful for employees who need to know what procedures they are responsible for performing unless the narrative is completely rewritten.
- Because of the static nature of the medium, narratives may be difficult to maintain and update as processes and controls change.
- It is easy for narratives to become bloated, which reduces their effectiveness. Narratives can be used to capture any and all information, but too much information and the text loses focus and becomes confusing.
- Narratives are a good way to communicate information, but the form does not readily lend itself to capturing information from operational personnel about information processes and controls.

Tips for Preparing Narratives

There are two basic ways you can use narratives in your documentation of internal control.

1. As the primary documentation means, supplemented by flowcharts, matrixes, or both
2. As a supplement to other forms of documentation

NARRATIVES AS THE PRIMARY DOCUMENTATION MEANS

The best way to prepare effective and efficient narrative documentation of internal controls is to develop *one* general format for the narrative and use it repeatedly to document all significant transactions. This consistency will benefit

- Documentation preparers, who will become more adept at documenting internal control if they are required to master only one general narrative structure
- Project team members and external auditors, who review internal control documentation and who will quickly appreciate reviewing a consistent format and approach
- Operations personnel who provide the information on processes and controls necessary to create good documentation

Additionally, with one standard narrative format, the company will be better able to ensure that all documentation contains each of the elements required by PCAOB Auditing Standard No. 2, and they will be able to more quickly modify documentation as changes to processes or controls change.

In developing a standard narrative structure, the main requirements are that

- The narrative structure includes all required documentation elements
- The narration is logically organized and easy to follow

The following is an example outline that achieves these objectives.

EXAMPLE OUTLINE: NARRATIVE DOCUMENTATION OF INTERNAL CONTROLS

- I. Overview
 - A. Description of transaction being described
 - B. General ledger accounts affected and relevant assertions
 - C. Business process owner and groups involved in the process
 - D. Subledger and subsidiary accounting records involved in the process
 - E. IT systems and electronic files involved in the process
- II. Transaction initiation
 - A. The process for initiating the transaction
 - B. Whether, and if so how, the process is documented

- C. The financial reporting–related risks inherent in the process (i.e., “what could go wrong?”)
 - D. Description of the controls in place to address the issues raised in C
 - 1. Who performs the control procedure
 - 2. How frequently and when the procedure is performed
 - 3. Whether, and if so how, the control procedure is documented
 - 4. Whether the control is computerized, manual, or a combination of both
 - 5. If applicable, an indication of which control(s) are key controls most responsible for ensuring that the financial reporting objectives related to the transaction are met
- III. Transaction authorization
- A. The policies and procedures followed for authorizing the transaction
 - B. Whether, and if so how, the performance of the authorization procedures is documented
 - C. The financial reporting–related risks inherent in the process (i.e., “what could go wrong?”)
 - D. Description of the controls in place to address the issues raised in C
 - 1. Who performs the control procedure
 - 2. How frequently and when the procedure is performed
 - 3. Whether, and if so how, the control procedure is documented
 - 4. Whether the control is computerized, manual, or a combination of both
 - 5. If applicable, an indication of which control(s) are key controls most responsible for ensuring that the financial reporting objectives related to the transaction are met
- IV. Recording the transaction
- A. The process for initially recording the transaction
 - B. Whether, and if so how, the recording of the transaction is documented
 - C. The financial reporting–related risks inherent in the initial recording of the transaction (i.e., “what could go wrong?”)
 - D. Description of the controls in place to address the issues raised in C
 - 1. Who performs the control procedure
 - 2. How frequently and when the procedure is performed
 - 3. Whether, and if so how, the control procedure is documented
 - 4. Whether the control is computerized, manual, or a combination of both
 - 5. If applicable, an indication of which control(s) are key controls most responsible for ensuring that the financial reporting objectives related to the transaction are met
- V. Transaction processing
- A. Once recorded, the information processing steps required to eventually post the transaction to the general ledger and any related subsidiary ledgers
 - B. Whether, and if so how, each step of the information processing is documented
 - C. The financial reporting–related risks inherent in each step of the information processing (i.e., “what could go wrong?”)
 - D. Description of the controls in place at each step to address the issues raised in C
 - 1. Who performs the control procedure
 - 2. How frequently and when the procedure is performed
 - 3. Whether, and if so how, the control procedure is documented

4. Whether the control is computerized, manual, or a combination of both
5. If applicable, an indication of which control(s) are key controls most responsible for ensuring that the financial reporting objectives related to the transaction are met

In reviewing the outline, note that

- After a brief overview of the transaction, the overarching structure follows the basic information processing stream and includes four of the five required elements of internal control documentation described in paragraph 42 of PCAOB Auditing Standard No. 2. This processing stream begins with the initiation of the transaction and ends with its posting to the general ledger. (The fifth required element, how the transaction is reported in the financial statements, is documented as part of the company's period-end financial reporting process.) This linear structure is logical and easy to follow.
- Within each section is the same information, organized in the same fashion. The organizational scheme described in the outline tracks with the COSO framework, which is echoed in PCAOB Auditing Standard No. 2. After describing how the information is processed, you discuss the financial reporting–related risks (“what could go wrong”) and how the control procedures are designed to mitigate those risks.
- The documentation of the other information listed in the outline are suggestions that will help you plan your tests of operating effectiveness.

To prepare a narrative consider the following:

- Distinguish between information *processes* and *controls*. A *process* changes or manipulates the data, for example, by performing a mathematical or logical operation. Extending an invoice by multiplying the number of items shipped by their sales price is a process. When data is processed, errors can occur.

A *control* is a procedure to prevent or detect the errors that can be introduced in the processing of data. Recalculating the extended invoice or otherwise is an example of a control.

Your narratives will be much clearer and easier to understand if you clearly distinguish between the information processing steps and the control procedures related to those steps.

- When considering “what could go wrong,” make sure to cover all relevant assertions for the affected account(s). Financial reporting–related risks are directly related to financial statement assertions. For example, there is a risk that not all authorized transactions will be recorded (completeness assertion) or that fictitious transactions will be processed (existence assertion). To make sure that you have considered all possible risks, review the relevant assertions and determine that each one has been addressed.
- When describing controls, check to make sure that at least one control has been identified to address each of the identified risks.
- When writing your narrative, use subheadings and bullet points to make the document more readable.

NARRATIVES AS A SUPPLEMENT TO OTHER FORMS OF DOCUMENTATION

Narratives can be used to supplement other forms of documentation such as a matrix or a flowchart. The most common ways to use narratives in this fashion include the following.

- Add analysis or higher-level understanding to a matrix. A matrix presents information at a high level of detail, and sometimes it is difficult for a user to absorb and understand its meaning. A narrative can be attached to a matrix to provide this type of analysis. For example, the narrative can provide an “executive summary” of your conclusions about design effectiveness or your approach to testing control effectiveness. The matrix itself would then serve the function of supporting detail that justifies your conclusions.
- Add detail and “walk the reader through” a flowchart. A flowchart presents highly summarized information. Narratives frequently are attached to flowcharts as a way to add details about the processing steps or related control procedures. In addition, some readers may find flowcharts vague or confusing (should they be read left to right? top to bottom? bottom to top?). A narrative can be added as a way to walk the reader through the sequencing of the processing steps to make sure there are no misunderstandings.

MATRIXES

A matrix is a spreadsheet of rows and columns. It is a two-dimensional worksheet that links a set of independent variables with a set of dependent variables. Typically, the control procedures comprise the independent variables, while the dependent variables are the various data about the control procedures that are required to be documented.

Strengths and Weaknesses

STRENGTHS OF MATRIXES AS A DOCUMENTATION METHOD FOR ROUTINE ACTIVITY-LEVEL CONTROLS

- They are highly effective at showing relationships or links between elements, for example, the link between the control procedure and the related financial statement assertion.
- They are an effective way to structure both the capture and the communication of information about information processes and controls.
- They are capable of capturing and relating a great deal of information.
- They are relatively easy to maintain and update.
- They are scalable and flexible.

WEAKNESSES OF MATRIXES AS A DOCUMENTATION METHOD FOR ROUTINE ACTIVITY-LEVEL CONTROLS

- They make it difficult to see the overall transaction flow and evaluate the effectiveness of control design.
- It is easy to document too much detail, making the matrix cumbersome to work with and confusing.

Tips for Preparing Matrixes

When preparing a matrix, the main problem you want to guard against is creating a matrix that tries to do *everything*, capturing or summarizing every conceivable detail about a control procedure. The result is an overload of information that is hard to understand. It is better to create a series of worksheets, each with just a few columns, rather than a worksheet with 30 columns.

A matrix is a simple database, and it helps to think of preparing a matrix in the same way that you would work with a database.

Each row in the matrix is like an input form in a database. The row is used to gather all the relevant information about your subject, for example, the control objective or control procedure. A database separates the information *gathering* function from the information *communication* function. A database has a report writer function that allows the user to choose selected data and present them in a concise, easily understandable format for the reader.

When preparing a matrix to document transactions and controls, you should consider a similar approach. Create a matrix to help capture the required elements and other information. From that master matrix, create a series of derivative tables, each of which is designed to achieve one objective.

Example Matrixes

The following are examples of individual matrixes you might consider. If you use a database program to warehouse control descriptions, then these matrixes describe the reports that you should consider writing from this database. If you use a spreadsheet program to create these matrixes, then common information between individual spreadsheets may be linked.

INFORMATION GATHERING MATRIX

Purpose

The purpose of this matrix is to facilitate the easy gathering of information about each control procedure. If you are working with a database, then this is the information that should be captured in your form to be stored in the database.

Creating the Matrix

The independent variable is the control number. The dependent variables are all of the relevant pieces you will need later to evaluate control design and track the testing of design and operating effectiveness. The following is a highly summarized example of the matrix—space constraints prevent us from showing all the details. A more detailed description of each dependent variable follows.

Financial Statement Information					Control Information			Control Number	Control Testing Information		
								001			
								002			
								003			

Information to Capture

The following are some suggestions on what information you should capture about each control, that is, the titles for each column in your matrix.

Financial Statement Information

- *Description of the transaction.* Examples of information that would be entered in this column are “sales,” “cash disbursements,” or “payroll.”
- *IT system.* This column would capture the name of the IT system involved in processing the transaction. This information is helpful when planning your IT-related tests, such as testing IT general or application controls or reviewing an SAS 70 report.
- *Electronic files.* Use this column to capture the name(s) of the electronic file(s) involved in processing. Again, this information will be useful when planning IT-related tests.
- *General ledger/accounts.* List the general ledger accounts that are affected as a result of this transaction, for example, “revenue” and “accounts receivable.”
- *Relevant assertions.* Describe the relevant assertions for the general ledger accounts affected by the transaction. “Completeness” is an example of a relevant assertion for sales transactions.

Control Information

- *Processing stage.* The PCAOB Auditing Standard requires documentation of each of the following stages of transaction processing:
 - Initiation
 - Authorization
 - Recording
 - Processing

Capturing this information will help you evaluate design effectiveness.

- *Control objective.* Control objectives are related to the financial statement assertions and stage of processing. For example, “To ensure that all valid sales transactions are captured at initiation” is an objective related to the completeness assertion at the initiation of the transaction.
- *Control description.* This is where you document your description of the control procedure. In addition to describing the procedure performed, you also may want to capture
 - The name of the responsible person or department
 - If or how the performance of the control procedure is documented

- Whether the control procedure is manual or automated
- How frequently the control procedure is performed
- Whether you consider the control procedure to be a “key control” for achieving the stated control objective, a determination that should be made only after evaluating the design effectiveness over the group of controls for a given transaction

Control Number

- Assign a unique control number to each control procedure.

Testing Information

- *Design effectiveness.* Use this column to track your conclusion as to whether the control procedure is designed effectively.
- *Operating effectiveness test procedure.* Describe, summarize, or cross-reference to the planned test(s) of operating effectiveness of the control.
- *Date test performed.* Track the date as of which the tests of operating effectiveness were performed. This information will help in determining whether and how tests will be updated to year-end.
- *Operating effectiveness conclusion.* Indicate your conclusion about whether the control is operating effectively.

EVALUATE CONTROL DESIGN BY PROCESSING STAGE

Purpose

Paragraph 42 of PCAOB Auditing Standard No. 2 requires the company to document “Sufficient information about the flow of transactions to identify the points at which material misstatements due to error or fraud could occur.” Technically, that requirement may be met by including this information in the information gathering matrix described earlier. However, an important purpose of the requirement is to allow you to assess the design effectiveness of the controls over the transaction. The following matrix will help you make this assessment.

How to Prepare the Matrix

Prepare a separate matrix for each significant transaction. If you are using a spreadsheet, sort your main information gathering spreadsheet first by transaction type and then by processing stage.

Example Matrix

Transaction: Sales					
Processing Stage	Assertion	Control Number	Control Description	Key Control?	
				Y	N
	Complete	002	Describe	<input type="checkbox"/>	<input type="checkbox"/>
Initiation	Complete	014	Describe	<input type="checkbox"/>	<input type="checkbox"/>
	Exist	005	Describe	<input type="checkbox"/>	<input type="checkbox"/>
		016	Describe	<input type="checkbox"/>	<input type="checkbox"/>
		017	Describe	<input type="checkbox"/>	<input type="checkbox"/>
	Accurate	004	Describe	<input type="checkbox"/>	<input type="checkbox"/>
		010	Describe	<input type="checkbox"/>	<input type="checkbox"/>
Authorization	Complete	002	Describe	<input type="checkbox"/>	<input type="checkbox"/>
Etc.					

How to Use the Matrix

For each transaction you should ascertain that controls exist for each relevant assertion for each of the four processing stages: initiation, authorization, recording, and processing (the reporting stage described in the Auditing Standard is covered in your review of entity-level controls). If there are no controls for an assertion or for a processing stage, then a flaw exists in the design of the controls for this transaction.

Next, review the description of each control procedure to determine whether it would be effective at addressing the stated assertion. Look at the group of controls aimed at the same assertion and determine which ones are “key controls” that should be tested.

EVALUATE CONTROL DESIGN BY ASSERTION

Purpose

Paragraph 42 of PCAOB Auditing Standard No. 2 requires the company to document “Controls over all relevant assertions.” Technically, that requirement may be met by including this information in the information gathering matrix described earlier. However, an important purpose of the requirement is to allow you to assess the design effectiveness of the controls over the transaction. The following matrix will help you make this assessment.

How to Prepare the Matrix

Prepare a separate matrix for each significant transaction. If you are using a spreadsheet, sort your main information gathering spreadsheet by transaction type and then by control number.

Example Matrix

Transaction: Sales								
Ctrl. No.	Control Description	Key	Assertions					
			Complete	Exist	Val.	Auth.	Rights	Disclose
001	Describe	Y	X	X		X		
002	Describe	Y				X		X
003	Describe	N						X
004	Describe	Y	X	X	X	X		
005	Describe	Y				X		
Etc.								

How to Use the Matrix

Review each control and determine which assertion the control relates to. When all controls for the transaction have been evaluated, review each column of assertions. A preponderance of controls for one assertion indicates that there probably is some control redundancy. Chances are that some of these controls are more significant than others—these should be your key controls. Reevaluate your planned tests of controls to make sure your testing plan focuses on these key controls. You may not have to test the others.

Conversely, if your analysis reveals a dearth of controls for a given assertion, that may indicate that a control deficiency exists because there are no controls to cover the assertion.

Finally, this matrix can help in evaluating the significance of control deficiencies. A deficient control related to an assertion for which redundant controls exist may not be considered significant if the redundant controls operate effectively. On the other hand, a deficiency in a control that is the only control for a given assertion probably will be at least a significant deficiency.

SUMMARIZE IT-RELATED CONTROLS TO PLAN SCOPE OF TESTS

Purpose

Coordinating the tests of IT controls can be challenging. One of the most important considerations in testing IT controls is making sure that the scope of the IT testwork is adequate—that it includes all the IT general and application controls that are relevant to internal control over financial reporting. This matrix can be used to help communicate with an IT specialist about the controls that should be included within the scope of his or her work.

How to Prepare the Matrix

If you are using a spreadsheet, sort your main information gathering spreadsheet by transaction IT system and then by general ledger account.

Example Matrix

IT System	G/L Account	Transaction Type	Ctrl. No.	Control Description
	Revenue	Sales	001	Description
			002	Description
			005	Description
Sales and Billing	Accts. Rec.	Sales	001	Description
			002	Description
			005	Description
			023	Description
			024	Description
	Sales Return	Sales Returns	037	Description
Etc.				

How to Use the Matrix

Use this matrix to communicate with the IT specialist important information about the scope of his or her work. From this matrix, the IT specialist will know which IT systems need to be included within the scope of the engagement and, for each system, which specific controls should be tested.

Checklist for Evaluating SOX 404 Software¹

PURPOSE

This form has been designed to

- Help evaluate the relative merits of different software tools to determine which tool is the best fit for your company

INSTRUCTIONS

1. Listed in the first column are the various criteria you might use in selecting a software tool. Review this list and modify it (add or delete criteria) to suit the needs of the entity.
2. Use the second column to weight each of the criteria according to how important it is to the entity. Use a five-point scale:
5 = critically important
1 = not at all important
3. Across the top row, list all of the software products the entity is considering.
4. Evaluate each product according to each criterion listed. Use a three-point scale:
3 = excellent
2 = good
1 = fair
5. In each cell of the matrix, enter the product of the value assigned to each column and row. For example, if a given product was rated excellent (3) for a criterion that was considered critically important (5), enter 15 in the related cell.
6. Total each column and compare the results for the various products.

¹This checklist originally appeared in the video training course Internal Control Reporting: A Guide to Effective Documentation, by Michael Ramos, published by the AICPA. Copyright © 2004 by AICPA, reproduced with permission. Opinions of the author are his own and do not necessarily reflect policies of the AICPA.

Selection Criteria	Criteria Weight 5 = Critical	Products				
		A	B	C	D	E
Product features						
Compliance with documentation requirements						
Consistency with COSO						
Ability to handle company-level controls						
Ease of use						
Security						
Quality of preloaded database of risks and controls						
Reporting capabilities						
Project management features						
Vendor's continued viability						
Vendor support						
Product compatibility with existing systems						
Product scalability						
Web-based interface						
Availability and quality of training						
Availability and quality of customization and implementation services						
Price						
Initial cost						
Ongoing charges						
Total						

PART III

Internal Control Testing Programs

Entity-Level Controls Testing Tools

The tools in this section are designed to help you plan, perform, and document your tests of entity-level control operating effectiveness.

- *Plan.* In order to successfully plan the tests of entity-level controls, you will need to have a good understanding of the company's stated policies and procedures. You should have obtained this understanding through your review of the relevant documentation, which may have been summarized on form DOC-1. Planning the tests of operating effectiveness will require you to make decisions regarding
 - The nature or types of tests you will perform
 - The timing of those tests
 - The extent of the testwork, for example, the number and names of the people who will be interviewed or surveyed
- *Perform.* The tool set in this section provides a variety of tools that will facilitate the collection of information about the operating effectiveness of entity-level controls. One of these tools is a work program, which is organized according to the types of tests you should consider performing. In general, there are four types of tests you may perform to test operating effectiveness:
 1. Inquiry of appropriate personnel
 2. Inspection of relevant documentation
 3. Observation of operations
 4. Reperformance of the test

Keep in mind that paragraph 40 of PCAOB Auditing Standard No. 2 states that inquiry alone is not sufficient to support an assertion about the operating effectiveness of internal control. Plan on performing a variety of tests.

- *Documentation.* Paragraph 20 of PCAOB Auditing Standard No. 2 requires you to support your evaluation of internal control with "sufficient evidence, including documentation," but no further guidance is provided on what you should document other than the results of your tests. (See paragraph 42 of the standard.)

The external auditors will review your documentation of the tests of controls. This review will allow them to determine that you

- Performed the necessary procedures
- Obtained sufficient evidence regarding the operating effectiveness of controls
- Reached appropriate conclusions

The tool set that follows will allow you to provide sufficient documentation of your tests by requiring you to document

- What you did
- What you found
- What you concluded

ORGANIZATION OF THE TOOL SET

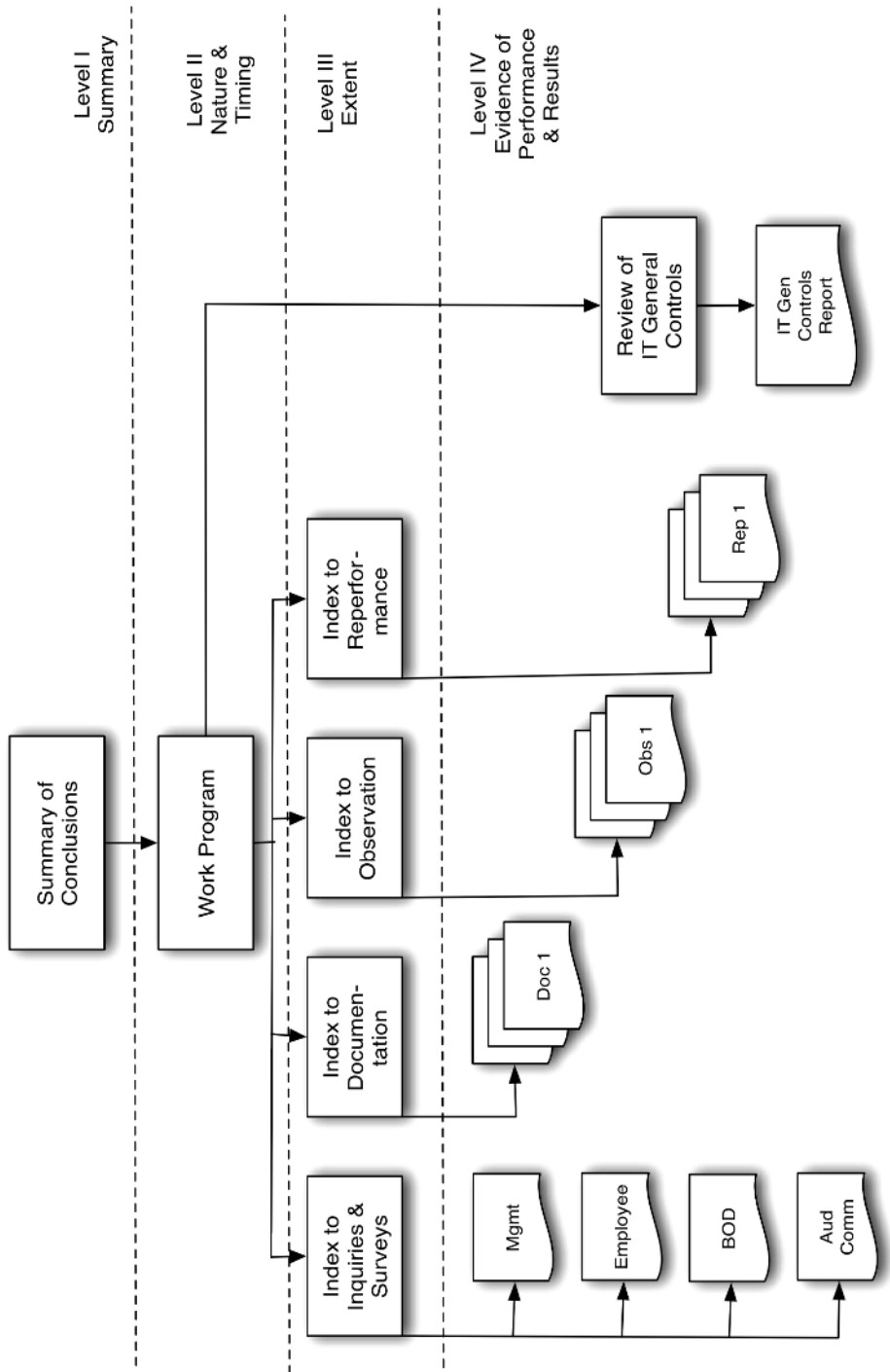
The tool set has been organized into four main levels of documentation, as indicated in the diagram that follows.

- *Summary of conclusions.* The worksheet at this level summarizes your conclusions about the key requirements of each entity-level control. By itself, the completion of this summary does *not* constitute sufficient evidence because it provides no indication of the tests performed or the results of these tests. The purpose of this summary is to enable the project team to assess the results of their tests and reach conclusions on the operating effectiveness of entity-level controls. It is intended that this worksheet be completed only after performing all the planned tests for the control.
- *Nature and timing of tests.* This work program provides example test procedures you can perform to obtain evidence about the operating effectiveness of entity-level controls. By completing this work program, you will document effectively the nature of the tests you performed and the timing of those tests.
- *Extent of tests.* These worksheets summarize the extent of your test procedures and, if necessary, allow you to document the factors you considered to determine that your extent of testing was sufficient. These worksheets also provide an index or table of contents to the detailed documentation that follows.
- *Evidence of performance and results.* These worksheets provide an easy-to-follow, standardized method for you to document the tests you performed, for example, the name of the person you made inquiries of, the questions you asked, and their responses.

This documentation scheme is designed to clearly provide the details necessary to support your conclusion about entity-level control effectiveness. The top-most level in the hierarchy—the conclusions reached about entity-level control effectiveness—is supported by the three levels beneath it. In order to reach a supportable conclusion about control effectiveness, you are required to

- Perform proper tests (Level II, nature of tests)
- Perform the tests within a time frame that allows you to draw a conclusion as of year-end (Level II, timing)
- Perform enough tests to reasonably support an opinion (Level III, extent of tests)
- Obtain results from tests that are consistent with the conclusions reached (Level IV, evidence of performance and results)

TESTS OF ENTITY-LEVEL CONTROLS DOCUMENTATION HIERARCHY



MAP TO COSO

The control environment is one of several entity-level controls included in this tool set. The tools included encompass all of the control environment elements describe in the COSO framework, but in a slightly reorganized fashion. The following table summarizes how the organization scheme of this document maps to the COSO framework.

COSO Component	Corporate Culture	Personnel
Integrity and Ethical Values	X	
Commitment to Competence		X
Board of Directors or Audit Committee	X	
Management’s Philosophy and Operating Style	X	
Organizational Structure		X
Assignment of Authority and Responsibility		X
Human Resource Policies and Practices	X	X

Summary of Observations and Conclusions about Entity-Level Control Effectiveness

PURPOSE

This form has been designed to

- Pull together the results of your procedures to test the operating effectiveness of entity-level controls and reach an overall conclusion as to their effectiveness
- Provide intermediate-level documentation on entity-level controls that is suitable for review by senior management, external auditors, or others with an interest in understanding the basis for your conclusions about entity-level controls

INSTRUCTIONS

This is a summary-level document. The conclusions documented on this form should be supported by the documentation of the results of your tests of entity-level controls. For each control you will perform a variety of tests, such as

- Inquiry of appropriate personnel
- Inspection of relevant documentation
- Observation of operations
- Reperformance of the control

Once you have completed all tests for a particular control, you should be able to complete the questions in the attached summary.

After completing the questions for each entity-level control, you should document your considerations of identified control testing exceptions (i.e., indications that an identified control is operating effectively nearly “always.”) This documentation of testing exceptions should include

- A description of the exceptions
- A conclusion as to whether the testing exception indicates a control deficiency and
 - If so, an evaluation of the significance of the deficiency
 - If not, an explanation of the evidence gathered to support your conclusions that the testing exception does not indicate a control deficiency

Guidance on evaluating testing exceptions and control deficiencies is provided in

- Paragraphs 130–140 of PCAOB Auditing Standard No. 2
- Appendix D of PCAOB Auditing Standard No. 2
- Answers to Q11–Q15 of PCAOB Staff Questions and Answers (June 23, 2004; see form ADM-3 for copies of this guidance)
- Answer Q35 of PCAOB Staff Questions and Answers (November 22, 2004)

All control deficiencies should be carried forward to a summary of control deficiencies for tracking and evaluation (e.g., form ADM-3).

ENTITY-LEVEL CONTROL TESTS

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

This form summarizes our observations and conclusions about the operating effectiveness of the company’s entity-level controls. This is a summary document only. The documentation of the nature, timing, and extent of the test procedures and the results of those procedures can be found where indicated in the column marked “Ref.”

For each consideration listed, we indicated our observation and/or conclusion by placing an X along a continuum ranging from “Never” (or “none”) to “Always” (or “all”).

Considerations Observations and Conclusions Ref.

Control Environment

CORPORATE CULTURE Never Sometimes Always

The company prepares written communications to document the entity’s values, norms, and acceptable behaviors. These documents include

- Code of conduct _____
- Charters for the board and other senior executive committees _____
- Other human resource policies _____

Management periodically reviews and modifies the company’s documentation of its values, norms, and acceptable behaviors. _____

Management effectively communicates its expectations for ethical conduct and acceptable behavior throughout the organization.

Employees receive training on ethical conduct and standards of acceptable behavior.

Senior management has

- Identified compensation policies or other incentives that may motivate unethical behavior by employees
- Taken action to mitigate the risks posed by these policies or incentives

When management becomes aware of any of the following, it takes appropriate action.

- Internal control deficiencies
- Overly aggressive or otherwise poor-quality accounting policies

Employees believe that those who

- Violate established codes of conduct and ethical behavior will be punished
- Adhere to the company's code of conduct and standards for ethical behavior will be looked upon favorably by management

Employees believe that the performance of the control activities to which they have been assigned is a top priority.

Employees believe that the company generally is ethical and that management acts with integrity.

ENTITY PERSONNEL AND ORGANIZATION

The entity's organizational structure facilitates the overall effective functioning of control policies and procedures.

Management appropriately considers internal control and financial reporting risks when determining the organizational structure of the company.

Management appropriately delegates responsibilities to lower levels.

Employees know which control-related activities they are required to perform. |_____||_____||

Employees know how to perform the control activities to which they have been assigned. |_____||_____||

Employees are provided with the resources necessary to perform their assigned responsibilities, including

- Information |_____||_____||
- Training |_____||_____||
- Funding/budget |_____||_____||
- Personnel |_____||_____||
- Supervision and performance feedback |_____||_____||

Employee competence is ensured through personnel policies such as

- Hiring |_____||_____||
- Compensation |_____||_____||
- Performance evaluation |_____||_____||
- Termination |_____||_____||

BOARD OF DIRECTORS OVERSIGHT

The board of directors

- Functions independently from management |_____||_____||
- Has the level of financial and other expertise necessary to effectively oversee the financial reporting process |_____||_____||

The board of directors and/or audit committee is actively involved in

- Oversight of the financial reporting process |_____||_____||
- Management’s risk assessment process |_____||_____||
- Monitoring the effectiveness of all elements of internal control, including the control environment |_____||_____||

ASSESSMENT OF CONTROL TESTING EXCEPTIONS—
CONTROL ENVIRONMENT

Our tests of the control environment revealed the following control exceptions, which we have evaluated as follows.¹

Description of Testing Exception	Evaluation of Testing Exception				
	Control Deficiency			Test Exception Not a Deficiency	
	Material Weakness	Significant Deficiency	Incon- sequential	No Deficiency	Ref.
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

Considerations	Observations and Conclusions			Ref.
Risk Assessment	Never	Sometimes	Always	
Management identifies risks that can prevent the company from publishing reliable financial statements.	<div></div>			
Identified financial reporting–related risks are analyzed and assessed.	<div></div>			

¹See instructions to form TST-ENT-1 for guidance on how to complete this section of the form. Use the column marked “Ref.” to reference to your documentation of the additional work performed to determine that the testing exception does not indicate a control deficiency.

Management identifies changes that could create new risks to publishing reliable financial statements. _____
These changes include

- Changed operating environment
- New personnel
- New or revamped IT systems
- Rapid growth
- New lines, products, or business activities
- Restructurings
- Foreign operations
- New accounting principles or other financial reporting requirements

**ASSESSMENT OF CONTROL TESTING EXCEPTIONS—
RISK ASSESSMENT**

Our tests of the risk assessment component of internal control revealed the following control exceptions, which we have evaluated as follows.²

Description of Testing Exception	Evaluation of Testing Exception				
	Control Deficiency			Test Exception Not a Deficiency	
	Material Weakness	Significant Deficiency	Inconsequential	No Deficiency	Ref.
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

²See instructions to form TST-ENT-1 for guidance on how to complete this section of the form. Use the column marked "Ref." to reference to your documentation of the additional work performed to determine that the testing exception does not indicate a control deficiency.

Description of Testing Exception	Evaluation of Testing Exception				
	Control Deficiency			Test Exception Not a Deficiency	
	Material Weakness	Significant Deficiency	Inconsequential	No Deficiency	Ref.
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

Considerations	Observations and Conclusions			Ref.
Monitoring	Never	Sometimes	Always	
Management receives all communication from external and internal parties relating to internal control effectiveness.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Management appropriately considers all communication received relating to internal control effectiveness.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Management takes appropriate action with respect to internal control deficiencies.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Periodically, physical assets are compared to the related accounting records.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Periodically, personnel confirm that they understand and have complied with the company's code of conduct.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Periodically, personnel responsible for performing critical control functions confirm that they have regularly performed these functions.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

ASSESSMENT OF CONTROL TESTING EXCEPTIONS—
MONITORING

Our tests of the monitoring component of internal control revealed the following control exceptions, which we have evaluated as follows.³

³See instructions to form TST-ENT-1 for guidance on how to complete this section of the form. Use the column marked “Ref.” to reference to your documentation of the additional work performed to determine that the testing exception does not indicate a control deficiency.

Description of Testing Exception	Evaluation of Testing Exception				
	Control Deficiency			Test Exception Not a Deficiency	
	Material Weakness	Significant Deficiency	Inconsequential	No Deficiency	Ref.
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

Considerations	Observations and Conclusions	Ref.
Period-End Financial Reporting	Never Sometimes Always	
Controls related to journal entries provide reasonable assurance that material misstatements will be prevented or detected.	<div></div>	
Controls related to the procedures used to record recurring and nonrecurring adjustments to the financial statements provide reasonable assurance that material misstatements will be prevented or detected.	<div></div>	
Controls over the drafting of the financial statements and related disclosures provide reasonable assurance that material misstatements will be prevented or detected.	<div></div>	
Management identifies significant estimates required to prepare the company’s financial statements.	<div></div>	
Accounting estimates are based on relevant, sufficient, and reliable data.	<div></div>	
Accounting estimates, including the support for the underlying assumptions, are appropriately reviewed and approved.	<div></div>	
Significant accounting estimates are compared to subsequent results to assess the reliability of the estimation process.	<div></div>	

Significant accounting estimates are consistent with _____
the operational plans of the company.

ASSESSMENT OF CONTROL TESTING EXCEPTIONS—
PERIOD-END FINANCIAL REPORTING

Our tests of the controls over the period-end financial reporting process revealed the following control exceptions, which we have evaluated as follows.⁴

Description of Testing Exception	Evaluation of Testing Exception				
	Control Deficiency			Test Exception Not a Deficiency	
	Material Weakness	Significant Deficiency	Incon- sequential	No Deficiency	Ref.
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

Considerations	Observations and Conclusions			Ref.
Selection and Application of Accounting Policies	Never	Sometimes	Always	

The audit committee is informed about

- a. The initial selection and application of significant accounting policies
- _____

⁴See instructions to form TST-ENT-1 for guidance on how to complete this section of the form. Use the column marked “Ref.” to reference to your documentation of the additional work performed to determine that the testing exception does not indicate a control deficiency.

b. Subsequent changes to the selection of significant accounting policies

c. Subsequent changes to the application of significant accounting policies

The audit committee is informed about the methods used to account for significant unusual transactions.

The audit committee is informed about the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative accounting guidance or consensus.

ASSESSMENT OF CONTROL TESTING EXCEPTIONS—
SELECTION AND APPLICATION OF ACCOUNTING PRINCIPLES

Our tests of the controls over the selection and application of accounting principles revealed the following control exceptions, which we have evaluated as follows.⁵

Description of Testing Exception	Evaluation of Testing Exception				
	Control Deficiency			Test Exception Not a Deficiency	
	Material Weakness	Significant Deficiency	Inconsequential	No Deficiency	Ref.
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

Considerations

Observations and Conclusions

Ref.

Audit Committee Oversight

Never Sometimes Always

Audit committee members are independent from company management.

⁵See instructions to form TST-ENT-1 for guidance on how to complete this section of the form. Use the column marked “Ref.” to reference to your documentation of the additional work performed to determine that the testing exception does not indicate a control deficiency.

Audit committee members understand their responsibilities.

The audit committee is actively involved and regularly interacts with groups such as

- External auditors
- Internal auditors
- Key members of financial management

The audit committee understands and appropriately responds to significant matters involving

- Internal control
- Financial reporting matters
- Antifraud processes and controls

ASSESSMENT OF CONTROL TESTING EXCEPTIONS—AUDIT COMMITTEE OVERSIGHT

Our tests of the effectiveness of audit committee oversight revealed the following control exceptions, which we have evaluated as follows.⁶

Description of Testing Exception	Evaluation of Testing Exception				
	Control Deficiency			Test Exception Not a Deficiency	
	Material Weakness	Significant Deficiency	Inconsequential	No Deficiency	Ref.
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

⁶See instructions to form TST-ENT-1 for guidance on how to complete this section of the form. Use the column marked “Ref.” to reference to your documentation of the additional work performed to determine that the testing exception does not indicate a control deficiency.

Description of Testing Exception	Evaluation of Testing Exception				
	Control Deficiency			Test Exception Not a Deficiency	
	Material Weakness	Significant Deficiency	Inconsequential	No Deficiency	Ref.
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

Considerations

Observations and Conclusions

Ref.

Antifraud Programs and Controls

Never

Sometimes

Always

The company culture is one of honesty and high ethics.

Management identifies and assesses the risks of fraud at the entity.

ASSESSMENT OF CONTROL TESTING EXCEPTIONS—
ANTIFRAUD PROGRAMS AND CONTROLS

Our tests of antifraud programs and controls revealed the following control exceptions, which we have evaluated as follows.⁷

Description of Testing Exception	Evaluation of Testing Exception				
	Control Deficiency			Test Exception Not a Deficiency	
	Material Weakness	Significant Deficiency	Inconsequential	No Deficiency	Ref.
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

⁷See instructions to form TST-ENT-1 for guidance on how to complete this section of the form. Use the column marked “Ref.” to reference to your documentation of the additional work performed to determine that the testing exception does not indicate a control deficiency.

Considerations	Observations and Conclusions			Ref.
IT General Controls	Never	Sometimes	Always	
The company develops and maintains an overall IT strategic plan.	<input type="text"/>	<input type="text"/>		
The company develops and maintains policies and procedures related to information architecture.	<input type="text"/>	<input type="text"/>		
The company develops and maintains policies and procedures that define the IT organization and relationships.	<input type="text"/>	<input type="text"/>		
The company develops and maintains policies and procedures that ensure compliance with external reporting requirements.	<input type="text"/>	<input type="text"/>		
The IT department develops and maintains risk assessment policies and procedures that address issues such as <ul style="list-style-type: none">• Technology reliability• Information integrity• IT personnel• Security assessments for all significant systems and locations	<input type="text"/>	<input type="text"/>		
The IT department develops, maintains, communicates, and monitors policies and procedures that ensure quality, including <ul style="list-style-type: none">a. IT systems documentation standardsb. Data integrity, ownership, and responsibilities	<input type="text"/>	<input type="text"/>		
ACQUIRE AND IMPLEMENT				
The IT department establishes, maintains, communicates, and monitors compliance with software acquisition and implementation policies and procedures.	<input type="text"/>	<input type="text"/>		
The IT department establishes, maintains, communicates, and monitors compliance with hardware acquisition and implementation policies and procedures.	<input type="text"/>	<input type="text"/>		
User reference and support manuals or other documentation help ensure the long-term sustainability of the IT system.	<input type="text"/>	<input type="text"/>		

The IT department tests new or modified systems, including

- a. Unit, system, integration, and user acceptance |_____|
- b. Load and stress testing |_____|
- c. Interfaces with other systems |_____|
- d. Data conversion |_____|

The IT department establishes, maintains, communicates, and monitors compliance with change management policies and procedures that address issues such as |_____|

- The override of established procedures, for example, in an emergency situation
- Plans for the timely change to systems and applications

DELIVERY AND SUPPORT

The IT department establishes, maintains, communicates, and monitors compliance with policies and procedures relating to the use of third-party service providers. These policies and procedures may include |_____|

- Vendor policies for selection of outsourced services
- Key performance indicators for managing service-level agreements
- Selection process for third-party service providers
- Third-party service contracts
- Policies and procedures for monitoring third-party service levels, including reviews of security, availability, and processing integrity

The IT department monitors the performance and capacity levels of the IT systems and, if measures are less than optimal, takes appropriate action. |_____|

The IT department establishes, updates, and tests a business continuity plan |_____|

The IT department establishes, maintains, communicates, and monitors compliance with system security policies and procedures, which address issues such as |_____|

- The development, updating, and maintenance of a security plan

- Methods used to authenticate users to the system
- Maintaining the effectiveness of authentication and access mechanisms
- The requesting, establishing, issuing, suspending, and closing of user accounts
- The prevention of unauthorized access to the network
- The performance of security assessments
- The monitoring of security activity and security violations

Personnel using IT services are educated and trained on the proper use of those services.

The IT department establishes, maintains, communicates, and monitors compliance with configuration management policies and procedures that address issues such as

- Software that is authorized to be used by employees
- The configuration of system infrastructure
- The configuration of application software
- The configuration of data storage
- Mitigation of risks posed by computer viruses
- Testing software and network infrastructure to ensure it is properly configured

The IT department establishes, maintains, communicates, and monitors compliance with policies and procedures relating to the management of problems and incidents.

The IT department establishes, maintains, communicates, and monitors compliance with data management policies and procedures that address issues such as

- Data processing controls, including those related to
 - The completeness of transaction processing
 - The accuracy of transaction processing
 - The authorization of transactions
 - The validity of transactions
- Controls over data input
- The handling, distribution, and retention of data and reporting output

- The protection of sensitive information during its storage and transmission
- The retention and storage of
 - Data
 - Programs
 - Reports
 - Documentation
- Physical security and accountability for data
- Changes in data structures

The IT department establishes, maintains, communicates, and monitors compliance with facilities management policies and procedures, such as

- Controlled access to facilities
- Environmental controls at physical facilities

The IT department establishes, maintains, communicates, and monitors compliance with operations management policies and procedures.

MONITORING

Significant IT processes are monitored.

ASSESSMENT OF CONTROL TESTING EXCEPTIONS—IT GENERAL CONTROLS

Our tests of IT general controls revealed the following control exceptions, which we have evaluated as follows.⁸

Description of Testing Exception	Evaluation of Testing Exception				
	Control Deficiency			Test Exception Not a Deficiency	
	Material Weakness	Significant Deficiency	Inconsequential	No Deficiency	Ref.
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

⁸See instructions to form TST-ENT-1 for guidance on how to complete this section of the form. Use the column marked "Ref." to reference to your documentation of the additional work performed to determine that the testing exception does not indicate a control deficiency.

Description of Testing Exception	Evaluation of Testing Exception				
	Control Deficiency			Test Exception Not a Deficiency	
	Material Weakness	Significant Deficiency	Inconsequential	No Deficiency	Ref.
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

Considerations	Observations and Conclusions	Ref.
Nonroutine Transactions	Never Sometimes Always	
Management identifies nonroutine transactions.	<div></div>	
The consummation of nonroutine transactions is authorized appropriately.	<div></div>	
The accounting treatment for nonroutine transactions is authorized appropriately.	<div></div>	

ASSESSMENT OF CONTROL TESTING EXCEPTIONS—NONROUTINE TRANSACTIONS

Our tests of the controls over nonroutine transactions revealed the following control exceptions, which we have evaluated as follows.⁹

⁹See instructions to form TST-ENT-1 for guidance on how to complete this section of the form. Use the column marked “Ref.” to reference to your documentation of the additional work performed to determine that the testing exception does not indicate a control deficiency.

Work Program for Testing Entity-Level Control Effectiveness

PURPOSE

This form has been designed to

- Provide a comprehensive list of tests you may perform to assess the operating effectiveness of entity-level controls
- Document the nature of the tests performed to gather information about the operating effectiveness of entity-level controls
- Track the progress the project team has made in testing entity-level controls

INSTRUCTIONS

The horizontal axis of the form is a summary of all entity-level controls that should be included in the scope of your assessment, *except for* information technology general controls. The work program for IT general controls can be found at TST-ENT-7. These entity-level controls are

- *Control environment.* The company's control environment, divided into its corporate culture element and personnel policies element.
- *Risk assess.* Management's process for identifying and assessing financial reporting-related risks.
- *Information and communication.* The information and communication component of internal control, which for entity-level controls, consists primarily of the communication subcomponent.
- *Monitoring.* Controls to monitor other controls and the results of operations.
- *Period-end reporting.* Controls over the period-end financial reporting process.
- *Accounting policies.* Controls over the selection and application of accounting policies in accordance with generally accepted accounting principles.
- *Audit committee.* Tests designed to evaluate the effectiveness of the company's audit committee.
- *Antifraud.* Controls designed to prevent or detect fraud.
- *Nonroutine transactions.* Controls over significant nonroutine and nonsystematic transactions, such as accounts involving judgments and estimates.

The first column of the form is a list of recommended test procedures. Cells that are filled with gray indicate that the recommended test procedure most likely does not provide direct evidence about the operating effectiveness of the related entity-level control.

You may determine that some recommended procedures are not considered necessary under the circumstances. You should indicate this conclusion by entering “ncn” in the appropriate cell. When choosing the mix of procedures to perform, be aware that PCAOB Auditing Standard No. 2 states that inquiry alone does not provide sufficient evidence to support the operating effectiveness of a control (see the fifth bullet of paragraph 40 of the standard).

Use this form to track the project team’s progress in testing entity-level controls. As a test procedure is completed, the person completing the test should initial and date the appropriate cell(s). You also may wish to provide a reference to where the performance of the test is documented.

TESTS OF ENTITY-LEVEL CONTROL OPERATING EFFECTIVENESS

This worksheet summarizes the nature of the tests we performed to evaluate the operating effectiveness of entity-level controls. The collective objectives of these tests were to

- Confirm that stated policies are being consistently followed by company personnel.
- Determine that entity-level controls provide an overall environment that enables the effective functioning of activity-level controls. To make this determination, our tests were designed to gather information about
 - *Awareness.* Company personnel’s awareness and understanding of relevant entity-level control policies.
 - *Attitude.* Company personnel’s attitude toward internal control in general and the adherence to stated entity-level controls, in particular.
 - *Actions.* Whether management’s actions and those of other personnel are consistent with stated company values and policies.
- Identify entity-level control deficiencies, to the extent such deficiencies exist.

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

Entity-Level Control										
Test Procedure	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
Planning										
These procedures may have been performed and documented on forms ADM-1 and ADM-2. If so, you should review this documentation before proceeding with your tests of controls.										
1. Determine which business units or locations are to be included within the scope of your testwork.										
2. Review other information sources to identify control deficiencies or other conditions or events that may indicate the existence of entity-level control deficiencies.										
Consider sources such as <ul style="list-style-type: none">• The company's recent SEC filings• Prior reports on entity-level control effectiveness, including those prepared by internal auditors										

Entity-Level Control										
Test Procedure	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
<ul style="list-style-type: none">• Communications from the external auditors, legal counsel, regulators, or other third parties• Findings or recommendations of the company's disclosure committee										
Understand Entity-Level Control Policies and Procedures										
These procedures may have been performed and documented on forms DOC-1 and DOC-1a. If so, you should review this documentation before proceeding with your tests of controls.										
3. Review the documentation pertaining to the company's stated entity-level control policies and procedures.										
Test Operating Effectiveness of Entity-Level Controls										
Inquiries or Written Surveys of Appropriate Personnel										
4. Determine overall objective(s) of your inquiry procedures or written surveys.										

	Entity-Level Control									
	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
Test Procedure										
5. Identify types of individuals who are most likely to be able to achieve stated inquiry objective(s). Consider <ul style="list-style-type: none"> • Management • Board members • Audit committee members • Financial personnel • Nonfinancial personnel 										
6. Determine the number of individuals from each category in step 5 who should be interviewed or surveyed to draw a reliable conclusion about the operating effectiveness of the tests.										
7. Determine the time period during which the interviews or surveys will be conducted and make necessary arrangements with interviewees.										
8. Conduct inquiries or surveys and document results.										

Test Procedure	Entity-Level Control									
	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
<i>Inspect Documentation</i> The documentation to be reviewed in this section is that related to the <i>implementation and performance</i> of the control procedures and not the documentation of the company's policies, which was addressed in step 3.										
Inspect relevant documentation that provides evidence that										
9. Key documents related to company values and acceptable behavior were communicated broadly throughout the organization.										
Key documents include <ul style="list-style-type: none"> • Code of conduct • Board of directors charter 										

Test Procedure	Entity-Level Control									
	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
<ul style="list-style-type: none"> • Audit committee charter • Charters for other senior committees • Other human resource policies 										
10. Key documents identified in step 9 were received, read, and understood by company personnel.										
11. Management has taken appropriate action regarding										
a. Mitigation of risks created by compensation policies or other incentive policies that may motivate unethical behavior by employees										
b. Internal control deficiencies										

	Entity-Level Control										
Test Procedure	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions	
	Culture	Personnel									
c. Overly aggressive or other accounting policies that are of poor quality											
d. The delegation of responsibility and organizational structure of the company											
e. Violations of the code of conduct or other unethical or unacceptable behaviors											
f. Reports of questionable accounting or auditing matters											
Such support may come from a variety of documents, including <ul style="list-style-type: none">Minutes of the board, the audit committee, or other committeesMemos and e-mails circulated internally, within the company											

Test Procedure	Entity-Level Control									
	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
<ul style="list-style-type: none"> • Written correspondence and e-mails with external third parties • Compliance with the provisions of Section 302 of the Sarbanes-Oxley Act requiring procedures for submission by employees of concerns regarding questionable accounting or auditing matters 										
12. Stated human resource policies relating to the following matters have been followed consistently.										
a. Hiring										
b. Compensation										
c. Performance evaluations										
d. Terminations										

	Entity-Level Control									
	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
Test Procedure										
13. Board members have complied with key provisions of the board charter, including those relating to the board's										
a. Independence										
b. Financial accounting and other expertise										
14. The board has been actively involved in										
a. Oversight of the financial reporting process										
b. Management's risk assessment process										
c. Monitoring the effectiveness of internal control										

Entity-Level Control										
Test Procedure	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
Documentation of the active involvement of the board may be found in <ul style="list-style-type: none">Board minutesBoard meeting agendas and other materials circulated in advance of the meeting										
15. Management has adhered to its stated process for allocating necessary resources to employees, including funding, personnel, and training.										
16. Management has actively engaged in a risk assessment process that includes the identification and analysis of the financial reporting–related risks for all key business processes.										

Test Procedure	Entity-Level Control									
	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
17. Management has identified and assessed risks related to changes in the company or its operating environment that create new risks to achieving its financial reporting objectives.										
<p>These changes may include</p> <ul style="list-style-type: none"> • Changed operating environment • New personnel • New or revamped IT systems • Rapid growth • New lines, products, or business activities • Restructurings • Foreign operations • New accounting principles or other financial reporting requirements 										

Test Procedure	Entity-Level Control									
	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
18. Physical assets, including inventory, have been compared to and reconciled with amounts recorded by the accounting system.										
19. Stated control procedures related to journal entries have been performed properly, consistently, and on a timely basis. These procedures include those relating to the way in which journal entries are										
a. Initiated										
b. Authorized										
c. Recorded										
d. Processed										

	Entity-Level Control									
Test Procedure	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
The performance of control procedures related to journal entries may be documented on the journal entry itself, if a paper-based copy of the journal entry exists. Inspecting a sample of journal entries may be sufficient to support an assessment that controls related to journal entries are effective.										
20. Stated control procedures related to adjustments to the financial statements (e.g., consolidating adjustments, report combinations, or classifications) have been performed properly, consistently, and on a timely basis.										
21. The need for preparing significant accounting estimates has been communicated to appropriate personnel.										

	Entity-Level Control									
	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
Test Procedure										
22. The person responsible for preparing an accounting estimate has accumulated relevant, sufficient, and reliable data on which to base the estimate.										
23. The process for preparing the accounting estimate has been reviewed.										
24. Management has reviewed the estimate to determine that it is consistent with										
a. Subsequent results										
b. The operational plans of the entity										
25. Audit committee members have complied with the company's stated independence policies.										

Test Procedure	Entity-Level Control									
	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
26. The audit committee has actively interacted with										
a. External auditors										
b. Internal auditors										
c. Key members of financial management										
Documentation of the active interaction of the audit committee with others may be found in <ul style="list-style-type: none"> Audit committee minutes Audit committee meeting agendas and other materials circulated in advance of the meeting 										
27. The audit committee has										
a. Been actively involved with and responded appropriately to significant internal control and financial reporting matters										

	Entity-Level Control										
Test Procedure	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions	
	Culture	Personnel									
b. Provided oversight of the company's antifraud processes and controls											
c. Been informed about the initial selection and application of accounting policies											
d. Been informed about changes to the selection of accounting policies											
e. Been informed about changes to the application of accounting policies											
f. Been informed about the methods used to account for significant unusual transactions											

	Entity-Level Control									
	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
Test Procedure g. Been informed about the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative accounting guidance or consensus										
Documentation of the active interaction of the audit committee with others may be found in <ul style="list-style-type: none"> • Audit committee minutes • Audit committee meeting agendas and other materials circulated in advance of the meeting • Correspondence with external auditors or other third parties 										
28. Management has followed the company's stated policies and procedures relating to the identification and assessment of fraud risk.										

	Entity-Level Control										
Test Procedure	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions	
	Culture	Personnel									
Documentation of the assessment of fraud risk may be found in the company's documentation of its overall risk assessment process.											
29. The consummation of and accounting for nonroutine transactions have been properly authorized.											
Documentation relating to the authorizing of and accounting for nonroutine transactions may be found in <ul style="list-style-type: none">Minutes of the board of directors, audit committee, or other senior committeesInternal memos and e-mailCorrespondence with external parties such as the independent auditors, the staff of the SEC, or legal counsel											

Test Procedure	Entity-Level Control									
	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
<i>Observation of Operations</i>										
30. Observe a meeting of the board of directors in which one or more of the following topics is discussed.										
a. Internal control deficiencies or other internal control matters, including communications from external parties on internal control effectiveness										
b. The quality of the company's accounting policies										
c. The operating budget or allocation of other resources such as personnel or training										
d. Published financial reports										

Test Procedure	Entity-Level Control									
	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
e. Management's assessment of risks facing the company, including fraud risks										
f. Nonroutine transactions, including their accounting treatment										
g. Disciplinary action taken with regard to violations of the code of conduct or other unethical behavior										
31. Observe a meeting of the audit committee in which one or more of the following topics is discussed.										
a. Internal control-related matters, including control deficiencies										

	Entity-Level Control									
	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
Test Procedure										
b. The initial selection of or subsequent changes to accounting policies										
c. The accounting policies in controversial or emerging areas										
d. Significant accounting estimates										
e. Other matters raised by the external auditors, including the quality of the company's accounting policies										
f. Nonroutine transactions, including their accounting treatment										
32. Observe a meeting of the audit committee in which one or more of the following participates.										

Test Procedure	Entity-Level Control									
	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
a. External auditors										
b. Internal auditors										
c. Key members of financial management										
33. Observe a meeting of the company's compensation committee, if any, or others involved in implementing the company's stated compensation and other incentive policies.										
34. Observe a meeting of the company's budget committee, if any, or others responsible for allocating resources to employees.										

	Entity-Level Control										
Test Procedure	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions	
	Culture	Personnel									
35. Observe management's deliberations regarding the risks facing the company, including fraud risks.											
36. Observe the counting of physical assets, including inventory.											
37. Observe meetings held by company personnel to draft or review interim or annual financial statements and related disclosures.											
38. Observe the operation of computer application controls related to the initiation, authorization, recording, or processing of journal entries.											

Test Procedure	Entity-Level Control									
	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
<i>Reperformance of the Control Procedure</i>										
39. On a test basis, reperform counts of physical assets.										
40. Assess the propriety of the adjustments to the financial statements such as consolidating adjustments, report combinations, and classifications.										
41. Determine that accounting estimates are consistent with data supporting the underlying assumptions used in the estimate.										

	Entity-Level Control										
Test Procedure	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions	
	Culture	Personnel									
42. Compare significant accounting estimates to subsequent results and assess the reliability of the process used to develop the estimate.											
43. Determine that the assumptions underlying significant estimates are consistent with management's operational plans.											
44. Verify information used to support the independence and financial expertise of board or audit committee members.											

Test Procedure	Entity-Level Control									
	Control Environment		Risk Assess	Information and Communication	Monitoring	Period End Reporting	Accounting Policies	Audit Committee	Anti-fraud	Nonroutine Transactions
	Culture	Personnel								
45. Review current published financial statements and identify significant accounting policies or changes to those policies or their application. Determine that the audit committee was informed of these policies or changes.										
46. Review current published financial statements and identify the accounting policies related to significant unusual transactions or transactions in controversial or emerging areas. Determine that the audit committee was informed of these policies.										

Index to Tests of Entity-Level Controls: Inquiries and Surveys

PURPOSE

This form has been designed to

- Summarize the extent of your inquiries and surveys of entity personnel and map these tests to the entity-level controls to which they relate
- Provide a centralized cross-reference to the documentation of the procedures performed and test results for entity-level controls

INSTRUCTIONS

There are four separate forms here, one for each category of individual you may interview or survey: management, board members, audit committee members, and employees.

Provide the name and any other relevant information (e.g., title) and enter this into the second column. In the third column, note the date on which the interview took place. In the first column, you should assign this item an identifying number as a way to cross-reference the reviewer to your description of the test performed and its results.

Check the appropriate boxes to indicate the entity-level control(s) to which the test relates. It is common for inquiries to provide evidence about the operating effectiveness of more than one control. Columns that are filled with gray indicate that the inquiries of this category of individual usually are not designed to provide evidence about that particular control. However, if you modify your planned inquiries to address these controls, then you should adjust your summary accordingly.

To this index you should attach summaries of the inquiries or a copy of the survey and the results of those procedures. The forms TST-ENT-3a–3b may be used for this purpose. One form should be completed for each person interviewed.

SUMMARY OF INTERVIEWS
MANAGEMENT

Ref.	Management Team Member Interviewed	Date	Entity-Level Control									
			Control Environment		Risk Assess	Information and Communication	Monitor	Period-End Reporting	Select Accounting Policies	Audit Committee	Antifraud	Nonroutine Transactions
			Culture	Personnel								
			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>

**SUMMARY OF INTERVIEWS
BOARD OF DIRECTORS**

Ref.	Board Member Interviewed	Date	Entity-Level Control									
			Control Environment		Risk Assess	Information and Communication	Monitor	Period-End Reporting	Select Accounting Policies	Audit Committee	Antifraud	Nonroutine Transactions
			Culture	Personnel								
			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>

**SUMMARY OF INTERVIEWS
AUDIT COMMITTEE**

Ref.	Audit Committee Member Interviewed	Date	Entity-Level Control									
			Control Environment		Risk Assess	Information and Communication	Monitor	Period-End Reporting	Select Accounting Policies	Audit Committee	Antifraud	Nonroutine Transactions
			Culture	Personnel								
			<input type="checkbox"/>			<input type="checkbox"/>			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
			<input type="checkbox"/>			<input type="checkbox"/>			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
			<input type="checkbox"/>			<input type="checkbox"/>			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
			<input type="checkbox"/>			<input type="checkbox"/>			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
			<input type="checkbox"/>			<input type="checkbox"/>			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
			<input type="checkbox"/>			<input type="checkbox"/>			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
			<input type="checkbox"/>			<input type="checkbox"/>			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

SUMMARY OF INTERVIEWS
EMPLOYEE

Ref.	Employee Interviewed	Date	Entity-Level Control									
			Control Environment		Risk Assess	Information and Communication	Monitor	Period- End Reporting	Select Accounting Policies	Audit Committee	Antifraud	Nonroutine Transactions
			Culture	Personnel								
			<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>					<input type="checkbox"/>	
			<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>					<input type="checkbox"/>	
			<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>					<input type="checkbox"/>	
			<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>					<input type="checkbox"/>	
			<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>					<input type="checkbox"/>	
			<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>					<input type="checkbox"/>	
			<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>					<input type="checkbox"/>	

Entity-Level Tests of Operating Effectiveness: Inquiry Note Sheets—Management

PURPOSE

This form has been designed to

- Help you prepare for an interview with management to assess the operating effectiveness of entity-level controls by providing you with example questions
- Document management's responses to your inquiries and your assessment of entity-level control operating effectiveness based on those responses

INSTRUCTIONS

Part I of this form is example questions you may ask management to gather evidence supporting the operating effectiveness of entity-level controls. Generally, these questions are designed to gather information about the following.

- *Awareness.* Management's awareness and understanding of entity-level control policies and procedures will help determine their overall effectiveness. Individuals who are responsible for implementing these control policies and procedures may be ineffective if they possess only a rudimentary awareness (or none at all) of the policies' existence. On the other hand, when these individuals have an in-depth understanding of the policies and procedures, the control objectives they address, and the implications of control failure, implementation of the policies will be more effective. Formal, consistent, and regular communication of entity-level controls (including training) will improve awareness and understanding.
- *Attitude.* To be effective, management personnel should have a positive attitude toward internal control compliance. Negative attitudes can render good policies and procedures ineffective. Positive attitudes include the belief that the performance of control procedures is a priority and that adhering to stated control policies and procedures provides benefit to the organization.
- *Action.* The actions of management members should be consistent with stated policies and procedures.

Part II of this form is a note sheet that you may use during your interview to document responses to your inquiries. Responses that provide evidence of the effective operation of controls should be separated from testing exceptions. Testing exceptions should be

accumulated and evaluated to determine whether a control deficiency exists. You may use this form to take notes during your interview or to prepare a summary of your observations after the interview is completed.

If you do not take notes contemporaneously with your interview, the documentation of your inquiries of management should be completed as soon as possible after the completion of the interview.

EXAMPLE QUESTIONS: MANAGEMENT (BOTH FINANCIAL AND NONFINANCIAL)

Control Environment—Culture

ESTABLISH AND COMMUNICATE VALUES, NORMS, AND ACCEPTABLE BEHAVIORS THROUGHOUT THE ORGANIZATION

- What process was followed to develop the company's code of conduct?
- How often is the code reviewed and updated?
- What was the main reason for developing the code?
 - Has that objective been met?
 - If so, how can you tell?
 - If not, what have been the major barriers to achieving the objective?
- Have you participated in management discussions about the company's culture and "tone at the top" and how these affect the overall effectiveness of controls?
 - If so, what observations has management made?
 - If not, what prevents you from doing so?

TAKE ACTION TO REINFORCE STATED VALUES, NORMS, AND ACCEPTABLE BEHAVIORS

- If management becomes aware of an allegation of unacceptable behavior, what is the process for investigating the matter?
 - Do you have any specific examples?
 - How was the action of management in this matter perceived by the employees?
- What was the process followed to implement the requirements of section 302 of the Sarbanes-Oxley Act relating to the establishment of procedures for the anonymous reporting by employees of concerns regarding questionable accounting or auditing matters?
 - Do you have specific examples of how management has followed up on these concerns?
- Has management identified compensation policies or other incentives that may motivate unethical behavior by employees?
 - If so, what are they? How do you monitor these policies for possible unintended consequences?
 - If not, why not? What criteria are considered when setting incentive policies and programs?

- Have you become aware of any control deficiencies in the last three years?
 - How did you become aware?
 - What action was taken?

Control Environment—Entity Personnel

THE COMPANY'S ORGANIZATIONAL STRUCTURE FACILITATES THE EFFECTIVE FUNCTIONING OF INTERNAL CONTROL

- How did management determine the overall organization's structure for the company?
 - When was the last time the structure was reviewed for continued relevance and effectiveness?
 - How do you determine that the structure is effective?
 - How are internal control and financial reporting matters considered when evaluating the company's organizational structure?
- Is there a formal process used to determine which responsibilities should be delegated to lower levels?
 - How do you ensure that responsibility, authority, and accountability are linked and delegated together as a unit?
 - How do you provide for an adequate segregation of duties?

HUMAN RESOURCE (HR) POLICIES CONTRIBUTE TO A CULTURE THAT IS COMMITTED TO COMPETENCE

- What is the process for determining the resources that are necessary for employees to perform their responsibilities effectively? Resources include
 - Training
 - Budget/funding
 - Personnel
 - Supervision and feedback
- Once management decides to pursue a certain strategy, what is the process for determining the human resource needs required to implement the strategy? Consider
 - Number of people needed
 - Required skills or competencies
 - Experience level
 - Training
- How successful has the company been at attracting and retaining the right number of qualified people necessary to achieve its goals? Which HR policies and programs have been most responsible for the company's success (or lack of success) in this area?

Control Environment—Overall Conclusion**OPINION ABOUT EFFECTIVENESS OF THE CONTROL ENVIRONMENT**

- Do you believe that the company has established standards of behavior and a “tone at the top” that creates an effective control environment, one that reflects an appropriate level of control consciousness within the organization?
 - What have you observed that leads you to this conclusion?

Risk Assessment**DISCUSSION OF THE RISK ASSESSMENT PROCESS**

- Describe the process used to identify the most significant business risks facing the company.
 - Who is involved in the process?
 - What criteria are used to determine the relative significance of the risks?
- How does the company decide how to manage identified risks?
- How is the board of directors involved in the risk management process?
 - What concerns and issues have they raised recently about the risks facing the entity?

**CHANGE MANAGEMENT AND THE ABILITY
TO IDENTIFY NEW RISKS FACING THE COMPANY**

- In the past three years, what have been the most significant changes to the company, its operations, or the business environment in which it operates?
 - What financial reporting challenges did these changes create?
 - Did management anticipate these challenges?
 - How quickly were you able to incorporate these changes into your financial reporting process?

Information and Communications**RECEIPT OF TIMELY, RELIABLE, AND COMPLETE INFORMATION**

- What financial information do you rely on to manage the company/business unit/department? How do you use this information?
- Do you receive all the information needed to perform your job effectively?
 - If so, is it reliable? Timely?
 - If not, what is missing?

Systemwide Monitoring

DISCUSSION OF MANAGEMENT'S INVOLVEMENT IN MONITORING INTERNAL CONTROL EFFECTIVENESS AND TAKING CORRECTIVE ACTION

- How does management
 - Obtain information on internal control effectiveness (e.g., from external or internal auditors)
 - Obtain confirmation from employees on their regular compliance with stated policies
- How often do you obtain this information?
- How confident are you that this information is
 - Accurate
 - Complete
 - Timely
- What steps does management take to
 - Understand the internal control implications of errors in the company's financial statements or accounting records
 - Understand the underlying causes for identified internal control deficiencies
 - Take appropriate corrective action in response to identified deficiencies

Antifraud Programs and Controls

CONSIDERATION AND RESPONSE TO FRAUD RISKS

- How does management specifically identify the company's vulnerability to
 - Employee theft or defalcation
 - Intentional manipulation of published financial information
- What actions has the company taken to reduce the risk of fraud at the entity?

SPECIFIC KNOWLEDGE OF FRAUD

- Are you aware of any fraud or suspected fraud affecting the entity?
 - If so, describe
 - What happened
 - Who was involved
 - How it was discovered
 - How the company responded

Nonroutine Transactions**DESCRIBE RECENT SIGNIFICANT NONROUTINE TRANSACTIONS AND THE RELATED CONTROLS OVER THE ACCOUNTING FOR AND REPORTING OF THESE TRANSACTIONS**

- What significant nonroutine transactions has the company entered into in the last year?
 - What was the business purpose of the transactions?
 - What procedures were followed to review the transactions and authorize their consummation?
 - How did the company decide on the proper accounting, reporting, and disclosure of these transactions?

ADDITIONAL QUESTIONS FOR FINANCIAL MANAGEMENT***Period-End Financial Reporting Processes*****CONTROLS OVER JOURNAL ENTRIES**

- How would an inappropriate journal entry be detected if it was posted to the system (or an attempt was made to post it to the system?)

CONTROLS OVER NONROUTINE TRANSACTIONS

- What is the process for structuring nonsystematic, nonroutine transactions?
 - What is driving these transactions, for example, are they necessary to
 - Implement the entity's strategic plan
 - Achieve forecasted financial results
 - At what point in the process does management receive input on the accounting treatment of these transactions?
 - Who provides this input?
 - What is the type and significance of the input received from external auditors?
 - What factors does the board consider when reviewing and approving these transactions?

CONTROLS OVER ACCOUNTING ESTIMATES

- What process does the entity follow for making its most significant accounting estimates?
 - How is information relating to the underlying assumptions gathered?
 - How do you know the information is reliable?
 - What factors are considered when making significant assumptions about the estimate?

- How is senior management and the board involved in the review and approval of significant estimates?
- In the company's most recent financial reporting cycle, what were the most significant issues raised by senior management or the board regarding the estimates or the estimation process?

CONTROLS OVER THE PREPARATION OF THE FINANCIAL STATEMENTS

- Who has the primary responsibility for drafting the financial statements?
- Who else participates in the process?
 - What is the type and significance of the input received from the external auditors?

Selection and Application of Accounting Policies

CONTROLS OVER THE SELECTION AND APPLICATION OF ACCOUNTING POLICIES

- Describe the conversations you have had with the independent auditors regarding the quality of the entity's accounting principles?
 - What actions did the board take as a result of those discussions?
- What is the process used by management to
 - Identify emerging accounting issues or other circumstances or events that may require a consideration of accounting policies
 - Choose appropriate accounting policies

NOTE SHEET INQUIRIES OF MANAGEMENT

Company: _____

Reporting Date: _____

Prepared by: _____

Date Prepared: _____

ALL MANAGEMENT PERSONNEL

Topic of Discussion	Evidence of Control Effectiveness			Testing Exception
	Awareness	Attitude	Action	
Control Environment				
Establish, communicate values, norms, acceptable behavior <ul style="list-style-type: none">• Develop code of conduct.• Discuss culture.				
Action to reinforce policies <ul style="list-style-type: none">• Allegations of unacceptable behavior, questionable accounting practices• Review of and response to incentives that may motivate unethical behavior• Correction of control deficiencies				
Organizational structure facilitates internal control effectiveness. <ul style="list-style-type: none">• Consider financial reporting and control when determining organizational structure.• Delegate responsibilities.				
HR policies and commitment to competence <ul style="list-style-type: none">• Provide resources to employees.• Identify number and type of people necessary to achieve objectives.• HR policies allow company to attract and retain right number of qualified people.				
Overall opinion on control environment effectiveness <ul style="list-style-type: none">• Standards of behavior and tone at top create appropriate level of control consciousness.				

Topic of Discussion	Evidence of Control Effectiveness			Testing Exception
	Awareness	Attitude	Action	
Risk Assessment				
Description of the risk assessment process <ul style="list-style-type: none">• Identification of risk• Risk management strategies• Active involvement of the board				
Change management <ul style="list-style-type: none">• Identification of changes to business that create financial reporting challenges• Ability to make timely changes to financial reporting process and controls				
Information and Communication				
Use of financial information to manage business				
Adequate communication of information necessary to perform job <ul style="list-style-type: none">• Reliable• Timely• Complete				
Monitoring				
Management monitors internal control effectiveness and takes action. <ul style="list-style-type: none">• Establish a process for periodically gathering information on internal control effectiveness.• Analyze and assess information received.• Take appropriate corrective action.				

Topic of Discussion	Evidence of Control Effectiveness			Testing Exception
	Awareness	Attitude	Action	
Antifraud Programs and Controls				
Consideration of and response to fraud risks <ul style="list-style-type: none">• Identification of risks related to both<ul style="list-style-type: none">- Employee theft or defalcation- Intentional manipulation of financial statements				
<ul style="list-style-type: none">• Actions taken to reduce fraud risk				
Specific knowledge of fraud <ul style="list-style-type: none">• Awareness of any fraud or suspected fraud at the entity• If so, provide details				
Nonroutine Transactions				
Description of nonroutine transactions <ul style="list-style-type: none">• Description of transaction• How transaction was reviewed and authorized• Process for determining proper accounting and reporting				

FINANCIAL MANAGEMENT

Topic of Discussion	Evidence of Control Effectiveness			Testing Exception
	Awareness	Attitude	Action	
Period-End Financial Reporting				
Controls over journal entries <ul style="list-style-type: none">• Detection of inappropriate journal entries				
Controls over nonroutine transactions <ul style="list-style-type: none">• Process for structuring transactions• How and when accounting treatment is considered• Extent and significance of external auditor input• Board involvement				
Controls over accounting estimates <ul style="list-style-type: none">• Estimation process• Involvement of senior management and board in reviewing estimates				
Controls over the preparation of the financial statements <ul style="list-style-type: none">• Primary responsibility for drafting the financial statements• Type and significance of external auditor involvement				
Selection and Application of Accounting Policies				
Controls over the selection and application of accounting policies <ul style="list-style-type: none">• Discussions with auditors regarding quality of accounting principles• Management's actions in response to these discussions• Process for choosing appropriate accounting policies				

Entity-Level Tests of Operating Effectiveness: Inquiry Note Sheets—Board Members

PURPOSE

This form has been designed to

- Help you prepare for an interview with board members to assess the operating effectiveness of entity-level controls by providing you with example questions
- Document the board member's responses to your inquiries and your assessment of entity-level control operating effectiveness based on those responses

INSTRUCTIONS

Part I of this form is example questions you may ask management to gather evidence supporting the operating effectiveness of entity-level controls. Generally, these questions are designed to gather information about the following.

- *Awareness.* The board of directors' awareness and understanding of entity-level control policies and procedures will help determine their overall effectiveness. Individuals who are responsible for implementing these control policies and procedures may be ineffective if they possess only a rudimentary awareness (or none at all) of the policies' existence. On the other hand, when these individuals have an in-depth understanding of the policies and procedures, the control objectives they address, and the implications of control failure, implementation of the policies will be more effective. Formal, consistent, and regular communication of entity-level controls (including training) will improve awareness and understanding.
- *Attitude.* To be effective, management personnel and the board should have a positive attitude toward internal control compliance. Negative attitudes can render good policies and procedures ineffective. Positive attitudes include the belief that the performance of control procedures is a priority and that adhering to stated control policies and procedures provides benefit to the organization.
- *Action.* The actions of management and the board should be consistent with stated policies and procedures.

Part II of this form is a note sheet that you may use during your interview to document responses to your inquiries. Responses that provide evidence of the effective operation

of controls should be separated from testing exceptions. Testing exceptions should be accumulated and evaluated to determine whether a control deficiency exists. You may use this form to take notes during your interview or to prepare a summary of your observations after the interview is completed.

If you do not take notes contemporaneously with your interview, the documentation of your inquiries of management should be completed as soon as possible after the completion of the interview.

EXAMPLE QUESTIONS

Control Environment—Culture

ESTABLISH AND COMMUNICATE VALUES, NORMS, AND ACCEPTABLE BEHAVIORS THROUGHOUT THE ORGANIZATION

- Have you read the company's code of conduct?
 - Do you believe it helps management and employees identify unacceptable business practices and behaviors?
- Have you participated in management discussions about the company's culture and "tone at the top" and how these affect the overall effectiveness of controls?
 - If so, what observations has management made?
 - If not, what prevents you from doing so?

TAKING ACTION TO REINFORCE STATED VALUES, NORMS, AND ACCEPTABLE BEHAVIORS

- If the board becomes aware of an allegation of unacceptable behavior, what is the process for investigating the matter?
 - Are you provided with sufficient and timely information on these allegations?
 - Do you have any specific examples of the board's involvement with an allegation of unacceptable behavior?
 - What action did management take in this matter?
- What was the board's involvement with implementing the requirements of section 302 of the Sarbanes-Oxley Act relating to the establishment of procedures for the anonymous reporting by employees of concerns regarding questionable accounting or auditing matters?
 - Do you have specific examples of how management has followed up on these concerns?
- Have you become aware of any control deficiencies in the last three years?
 - How did you become aware?
 - What action was taken?

BOARD STRUCTURE AND OVERSIGHT OF MANAGEMENT

- How do board members monitor and retain their independence from management?
- Are board members sufficiently independent that necessary questions are raised, even if the questions are difficult and probing?
 - What are some examples of these types of questions that have been raised recently?
- How does the board acquire and maintain an appropriate level of financial expertise?

Control Environment—Overall Conclusion***Opinion about the Effectiveness of the Control Environment***

- Do you believe that the company has established standards of behavior and a “tone at the top” that creates an effective control environment, one that reflects an appropriate level of control consciousness within the organization?

Risk Assessment**BOARD INVOLVEMENT WITH THE RISK ASSESSMENT PROCESS**

- How is the board of directors involved in the risk management process?
 - What concerns and issues have they raised recently about the risks facing the entity?

Information and Communication

- Do you receive all the information needed to monitor management’s objectives and strategies, the entity’s financial position and operating results, and terms of significant agreements?
 - If so, is this information reliable? Timely? Sufficient?
 - If not, what is missing?

Selection and Application of Accounting Policies**CONTROLS OVER THE SELECTION AND APPLICATION OF ACCOUNTING POLICIES**

- Describe the conversations the board has had with the independent auditors regarding the quality of the entity’s accounting policies?
 - What actions did the board take as a result of those discussions?

Antifraud Programs and Controls

SPECIFIC KNOWLEDGE OF FRAUD

- Are you aware of any fraud or suspected fraud affecting the entity?
 - If so, describe
 - What happened
 - Who was involved
 - How it was discovered
 - How the company responded

Nonroutine Transactions

**BOARD AWARENESS OF AND INVOLVEMENT
WITH NONROUTINE TRANSACTIONS**

- What significant nonroutine transactions has the company entered into in the last year?
 - What was the business purpose of the transactions?
 - What procedures were followed to review the transactions and authorize their consummation?
- To what extent was the board involved in the review and approval of
 - The transaction
 - The accounting for and reporting of the transaction

NOTE SHEET INQUIRIES OF BOARD MEMBERS

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

Topic of Discussion	Evidence of Control Effectiveness			Testing Exception
	Awareness	Attitude	Action	
<i>Control Environment</i>				
Establish and communicate values, norms, and acceptable behaviors. <ul style="list-style-type: none">• Reading of code of conduct• Effectiveness of code of conduct				

Topic of Discussion	Evidence of Control Effectiveness			Testing Exception
	Awareness	Attitude	Action	
Control Environment				
<ul style="list-style-type: none">Board discussions on company culture				
Take action to reinforce stated values, norms, and acceptable behaviors. <ul style="list-style-type: none">Process for investigating allegations of unacceptable behaviorBoard involvement with procedures for investigating concerns about questionable accounting mattersBoard response to identified control deficiencies				
Board structure and oversight of management <ul style="list-style-type: none">Maintain independence.Board members ask difficult and probing questions of management.Maintain appropriate level of financial expertise.				
Opinion about effectiveness of control environment <ul style="list-style-type: none">Establishment of standards of behavior and tone at top that creates effective control environment				
Information and Communication				
Adequate communication of information necessary to perform job <ul style="list-style-type: none">ReliableTimelyComplete				

Topic of Discussion	Evidence of Control Effectiveness			Testing Exception
	Awareness	Attitude	Action	
Risk Assessment				
Board involvement with risk assessment process <ul style="list-style-type: none">• Process for ensuring board’s involvement• Board concerns about risks facing the company				
Selection and Application of Accounting Policies				
Board involvement with the selection and application of accounting policies <ul style="list-style-type: none">• Discussions regarding quality of accounting policies• Board response to these discussions				
Antifraud Programs and Controls				
Specific knowledge of fraud <ul style="list-style-type: none">• Awareness of any fraud or suspected fraud at the entity• If so, provide details				
Nonroutine Transactions				
Board awareness and involvement with nonroutine transactions <ul style="list-style-type: none">• Description of significant nonroutine transactions• Board review and approval of transaction• Board review and approval of related accounting and reporting				

Entity-Level Tests of Operating Effectiveness: Inquiry Note Sheets—Audit Committee Members

PURPOSE

This form has been designed to

- Help you prepare for an interview with audit committee members to assess the operating effectiveness of entity-level controls by providing you with example questions
- Document the audit committee members' responses to your inquiries and your assessment of entity-level control operating effectiveness based on those responses

INSTRUCTIONS

Part I of this form is example questions you may ask management to gather evidence supporting the operating effectiveness of entity-level controls. Generally, these questions are designed to gather information about the following.

- *Awareness.* The audit committee's awareness and understanding of entity-level control policies and procedures will help determine their overall effectiveness. Individuals who are responsible for implementing these control policies and procedures may be ineffective if they possess only a rudimentary awareness (or none at all) of the policies' existence. On the other hand, when these individuals have an in-depth understanding of the policies and procedures, the control objectives they address, and the implications of control failure, implementation of the policies will be more effective. Formal, consistent, and regular communication of entity-level controls (including training) will improve awareness and understanding.
- *Attitude.* To be effective, management personnel and the audit committee should have a positive attitude toward internal control compliance. Negative attitudes can render good policies and procedures ineffective. Positive attitudes include the belief that the performance of control procedures is a priority and that adhering to stated control policies and procedures provides benefit to the organization.
- *Action.* The actions of management and the board should be consistent with stated policies and procedures.

Part II of this form is a note sheet that you may use during your interview to document responses to your inquiries. Responses that provide evidence of the effective operation of controls should be separated from testing exceptions. Testing exceptions should be accumulated and evaluated to determine whether a control deficiency exists. You may use this form to take notes during your interview or to prepare a summary of your observations after the interview is completed.

If you do not take notes contemporaneously with your interview, the documentation of your inquiries of management should be completed as soon as possible after the completion of the interview.

EXAMPLE QUESTIONS

Control Environment—Culture

TAKING ACTION TO REINFORCE STATED VALUES, NORMS, AND ACCEPTABLE BEHAVIORS

- What was the audit committee's involvement with implementing the requirements of section 302 of the Sarbanes-Oxley Act relating to the establishment of procedures for the anonymous reporting by employees of concerns regarding questionable accounting or auditing matters?
 - Do you have specific examples of how management and the audit committee have followed up on these concerns?
- Have you become aware of any control deficiencies in the last three years?
 - How did you become aware?
 - What action was taken?

Information and Communication

- Do you receive all the information needed to carry out your responsibilities?
 - If so, is this information reliable? Timely? Sufficient?
 - If not, what is missing?

Selection and Application of Accounting Policies

CONTROLS OVER THE SELECTION AND APPLICATION OF ACCOUNTING POLICIES

- What discussions has the audit committee had in the past year regarding
 - The initial selection and application of significant accounting policies
 - Subsequent changes to the selection of significant accounting policies
 - Subsequent changes to the application of significant accounting policies
 - The methods used to account for significant unusual transactions
 - The effect of significant accounting policies in controversial or emerging areas

- Do you believe that the audit committee is well informed of these matters?
 - If so, what steps are taken to ensure that you remain well informed?
 - If not, how could the process for informing the audit committee of matters affecting the selection or application of accounting policies be improved?
- Describe the conversations the audit committee has had with the independent auditors regarding the quality of the entity's accounting policies?
 - What actions did the board take as a result of those discussions?

Audit Committee Oversight

AUDIT COMMITTEE STRUCTURE AND OVERSIGHT OF MANAGEMENT

- How do audit committee members monitor and retain their independence from management?
- Are audit committee members sufficiently independent that necessary, even if difficult and probing, questions are raised?
 - What are some examples of these types of questions that have been raised recently?
- How does the audit committee acquire and maintain an appropriate level of financial expertise?

UNDERSTANDING OF RESPONSIBILITIES

- How were your responsibilities as an audit committee member communicated to you?
- Do you believe that you have a sufficient understanding of these responsibilities?
 - If so, what steps did the company take to ensure that you obtained this understanding?
 - If not, how could the process for informing audit committee members of their responsibilities be improved?

ACTIVE INVOLVEMENT OF THE AUDIT COMMITTEE IN SIGNIFICANT MATTERS

- In the past year, what significant issues has the committee become involved with?
Consider
 - Internal control matters
 - Financial reporting matters
 - Antifraud processes and controls
- How would you describe the interactions the audit committee has with
 - The company's external auditors
 - Internal auditors
 - Key members of financial management

Antifraud Programs and Controls**SPECIFIC KNOWLEDGE OF FRAUD**

- Are you aware of any fraud or suspected fraud affecting the entity?
 - If so, describe
 - What happened
 - Who was involved
 - How it was discovered
 - How the company responded

NOTE SHEET INQUIRIES OF AUDIT COMMITTEE MEMBERS

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

Topic of Discussion	Evidence of Control Effectiveness			Testing Exception
	Awareness	Attitude	Action	
<i>Control Environment</i>				
Action to reinforce stated values, norms, and acceptable behaviors <ul style="list-style-type: none"> • Procedures for reporting by employees of concerns regarding questionable accounting matters and subsequent follow-up by management • Audit committee awareness of control deficiencies • Audit committee involvement in correcting control deficiencies 				
<i>Information and Communication</i>				
Adequate communication of information necessary to perform job <ul style="list-style-type: none"> • Reliable • Timely • Complete 				

Evidence of Control Effectiveness			
Topic of Discussion	Awareness	Attitude	Action
<i>Selection and Application of Accounting Policies</i>			
<p>Audit committee involvement in the selection and application of accounting policies</p> <ul style="list-style-type: none"> • Initial selection and application • Subsequent changes to selection or application • Accounting for unusual transactions • Accounting in controversial or emerging areas • Conversations with auditors and subsequent response by company on quality of accounting policies 			
<i>Audit Committee Oversight</i>			
<p>Audit committee structure</p> <ul style="list-style-type: none"> • Maintain independence. • Ask difficult and probing questions. • Maintain financial expertise. 			

Topic of Discussion	Evidence of Control Effectiveness			Testing Exception
	Awareness	Attitude	Action	
Understanding responsibilities <ul style="list-style-type: none"> • Establish process for communicating responsibilities to audit committee members. • Audit committee members have good understanding of their responsibilities. 				
Active involvement in significant matters <ul style="list-style-type: none"> • Internal control • Financial reporting • Antifraud • Interactions with external and internal auditors and financial management 				
<i>Antifraud Programs and Controls</i>				
Specific knowledge of fraud <ul style="list-style-type: none"> • Awareness of any fraud or suspected fraud at the entity • If so, provide details 				

Entity-Level Tests of Operating Effectiveness: Inquiry Note Sheets—Employees

PURPOSE

This form has been designed to

- Help you prepare for an interview with financial and nonfinancial employees to assess the operating effectiveness of entity-level controls by providing you with example questions
- Document the employees' responses to your inquiries and your assessment of entity-level control operating effectiveness based on those responses

INSTRUCTIONS

Included in this form are example questions you may ask employees to gather evidence supporting the operating effectiveness of entity-level controls. Generally, these questions are designed to gather information about the following.

- *Awareness.* Company personnel awareness and understanding of entity-level control policies and procedures will help determine their overall effectiveness. Individuals who are responsible for following these control policies and procedures may do so ineffectively if they possess only a rudimentary awareness (or none at all) of the policies' existence. On the other hand, when these individuals have an in-depth understanding of the policies and procedures, the control objectives they address, and the implications of control failure, implementation of the policies will be more effective. Formal, consistent, and regular communication of entity-level controls (including training) will improve awareness and understanding.
- *Attitude.* For controls to be effective, company personnel should have a positive attitude toward compliance. Negative attitudes can render good policies and procedures ineffective. Positive attitudes include the belief that the performance of control procedures is a priority and that adhering to stated control policies and procedures provides benefit to the organization.
- *Action.* The actions of management members should be consistent with stated policies and procedures. Company personnel often are able to observe management actions and comment on the message such actions convey.

This form also includes a note sheet that you may use during your interview to document responses to your inquiries. Responses that provide evidence of the effective operation of controls should be separated from testing exceptions. Testing exceptions should be accumulated and evaluated to determine whether a control deficiency exists. You may use this form to take notes during your interview or to prepare a summary of your observations after the interview is completed.

If you do not take notes contemporaneously with your interview, the documentation of your inquiries of management should be completed as soon as possible after the completion of the interview.

EXAMPLE QUESTIONS

Control Environment—Culture

UNDERSTANDING AND ATTITUDES TOWARD THE COMPANY'S CODE OF CONDUCT

- Have you read the company's code of conduct?
 - If so, then do you find that it helps you identify unacceptable business practices and behaviors?
 - If not, why not?
- What happens (or what do you think will happen) if you observe unacceptable behavior on the job and report it to a member of senior management? Will the matter be investigated promptly? Thoroughly?
- What happens (or what do you think will happen) if someone raises concerns regarding questionable accounting or auditing matters? Will the matter be investigated promptly? Thoroughly?
- Are people in the company who demonstrate a commitment to high ethical standards of behavior rewarded (e.g., through compensation or advancement)?
- Are people who act in an unethical manner punished (e.g., through diminished compensation, lack of advancement, or termination)?

OBSERVABLE ACTIONS THAT REINFORCE OR CONTRADICT STATED VALUES, NORMS, AND ACCEPTABLE BEHAVIORS

- In the last three years, have you been asked by someone senior to you to take action that would be considered unethical?
- Do you know anyone at the company who, in the last three years, has been asked by someone senior to them to take action that would be considered unethical?
- For the most part, do company employees act in an ethical manner?
- For the most part, does company management act in an ethical manner? Do they set a good example of ethical behavior?

Control Environment—Personnel Policies**UNDERSTANDING OF JOB RESPONSIBILITIES AND APPROPRIATE SUPERVISION AND FEEDBACK**

- Have your job responsibilities been communicated to you? How?
- Do you believe that you have a good understanding of your job responsibilities?
- Do you know how your performance will be evaluated?
- Does the feedback you receive on your job performance help you improve?
- Does the training you receive improve your job performance?

AVAILABILITY OF RESOURCES TO PERFORM ASSIGNED DUTIES

- Have you been delegated the decision-making authority necessary to effectively perform your job?
- For the most part, have you been provided with the following resources necessary to perform your job effectively?
 - Budget/funding
 - Personnel
 - Supervisory guidance

Control Environment—Overall Conclusion**OPINION ABOUT EFFECTIVENESS OF CONTROL ENVIRONMENT**

- Are there any other aspects of the company's culture or management policies that contribute to or detract from your performing your job effectively? If a family member or friend were considering employment at this company and asked, "What's it like working there?" how would you respond?

Information and Communication**RECEIPT OF TIMELY, RELIABLE, AND COMPLETE INFORMATION**

- Is the information you need to perform your job communicated to you
 - Accurately
 - In a timely fashion
 - Completely

Antifraud Programs and Controls**KNOWLEDGE OF ANY FRAUD**

- Are you aware of any fraud or suspected fraud affecting the entity?
 - If so, describe
 - What happened
 - Who was involved
 - How it was discovered
 - How the company responded

**NOTE SHEET
INQUIRIES OF EMPLOYEES**

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

	Evidence of Control Effectiveness			
Topic of Discussion	Awareness	Attitude	Action	Testing Exception
Control Environment				
Understanding and attitudes about stated values, norms, and acceptable behaviors <ul style="list-style-type: none">• Understanding of code of conduct• Perceived consequences of unacceptable behavior• Rewards and punishments for compliance with stated policies				
Observable actions that reinforce or contradict stated values, norms, and acceptable behaviors <ul style="list-style-type: none">• Knowledge of management asking employee to take action considered unethical• Perception of whether employees act ethically• Perception of whether management acts ethically				

Topic of Discussion	Evidence of Control Effectiveness			Testing Exception
	Awareness	Attitude	Action	
Antifraud Programs and Controls				
Specific knowledge of fraud <ul style="list-style-type: none">• Awareness of any fraud or suspected fraud at the entity• If so, provide details				

Example Employee Survey¹

PURPOSE

This example has been provided to help you

- Conduct a survey of employees to gather information about the operating effectiveness of entity-level controls
- Evaluate the results of those surveys

INSTRUCTIONS

There are three separate tools that will help you in conducting employee surveys related to the operating effectiveness of entity-level controls. Included are

- Example Letter to Employees in Advance of Employee Survey
- Example Employee Survey of Corporate Culture and Personnel Policies
- Evaluation of Employee Survey Results

Each example provides a separate set of instructions for its use.

EXAMPLE LETTER TO EMPLOYEES IN ADVANCE OF EMPLOYEE SURVEY

INSTRUCTIONS

- This letter should be sent out a week or two in advance of sending the actual employee survey. The purpose of the letter is to prepare the employees for its arrival and to encourage them to complete it as soon as possible.
- The letter assumes that *all* employees will receive a survey. If that is not the case, then the letter should explain how the individual employee was selected; for example, “We are sending the survey to 50 percent of all our employees and management. Your name has been selected at random.”
- To convey a proper sense of urgency and importance to the completion of the survey, the letter should be signed by a member of senior management, for example, the CEO.

¹ These tools originally were published in a slightly different form in *How to Comply with Sarbanes-Oxley Section 404*, by Michael Ramos, published by John Wiley & Sons (2004).

EXAMPLE LETTER TO EMPLOYEES IN ADVANCE OF EMPLOYEE SURVEY

Dear _____,

We are required by law to annually review and report on the policies and procedures we use to manage and control our company. The scope of this review is quite broad and includes evaluating not just individual tasks you perform in your daily work assignments but also the environment in which you perform those assignments.

To help us perform our review we are conducting a survey of all employees to obtain their observations about the way in which our company is managed. Within the next two weeks you will be receiving this survey. We have tried hard to balance our need for comprehensive feedback with everyone's desire to keep the survey as short as possible. We believe we have reached a suitable compromise.

I urge you to complete this survey and return it as soon as possible to _____. Your prompt attention to this matter is important, not only because it will allow us to comply with certain legal requirements, but also because it will help us to continually improve our management practices. All individual responses to the questionnaire will be kept strictly confidential.

/s/ Chief Executive Officer

EXAMPLE EMPLOYEE SURVEY OF CORPORATE CULTURE AND PERSONNEL POLICIES

INSTRUCTIONS

- Included with the example survey is a cover sheet to the employee/respondent, which explains the purpose of the survey, how to fill it out, and confidentiality policies.
- If you are an outside consultant who has been engaged by the company to conduct the survey, you should print the survey on your letterhead, as this will reinforce the message that responses are confidential and encourage more candid responses.
- All responses should be returned directly to you.
- Questions 4 through 9 make reference to "high ethical standards" and personal ethics, which may introduce an element of unreliability to the survey because what may be unacceptable to one person may be acceptable to another. Alternatively, the questions may be reworded to refer to the company's stated ethical policies or values. However, if you choose to refer to company policies in these questions, you should include these policies as part of the survey. Without easy, immediate access to the company's stated policies, most individuals will not be able to respond to the statement.
- The example behaviors listed in question 18 have been deliberately worded in a way that makes them all seem positive. If negative behaviors are noted in response to this question, then this could indicate the strong presence of negative elements in the entity's control environment. The question leads the respondent to consider only positive char-

acteristics. If the employee makes note of negative characteristics, it is probably because these characteristics have made a strong impression on the respondent.

EXAMPLE SURVEY OF EMPLOYEES

Purpose of the Survey

By law, XYZ Company is required to review and report on the policies and procedures used to manage and control the company. The scope of this review is broad and includes an evaluation of the overall environment in which individual employees perform their assigned responsibilities.

The purpose of this survey is to obtain input from all employees on how the company is managed.

Confidentiality

Individual responses will not be disclosed. All responses will be evaluated as a group and reported to company management in a summarized fashion.

Instructions

Please respond by indicating the degree to which you agree or disagree with the statements presented. When you are done, please mail your completed questionnaire to _____. A self-addressed, stamped envelope has been provided for your convenience.

Survey of the Employees of ABC Corporation

ETHICAL VALUES	Strongly Disagree	Disagree	Neither Agree nor Disagree	Agree	Strongly Agree
1. I have read the company's code of conduct.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. The company's code of conduct helps me identify unacceptable business practices.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. If I observe unacceptable behavior on the job and report it to a member of the management team, I believe that the matter will be investigated.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

	Strongly Disagree	Disagree	Neither Agree nor Disagree	Agree	Strongly Agree
4. I believe that people who demonstrate a commitment to high ethical standards of behavior will be rewarded (e.g., through compensation or advancement).	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. I believe that people who act in an unethical manner will be punished (e.g., through diminished compensation, lack of advancement, or termination).	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. In the last three years, I have been asked by someone senior to me to take action that would be considered unethical.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. I know someone at the company who, in the last three years, has been asked by someone senior to them to take action that would be considered unacceptable.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. For the most part, company employees act in an ethical manner.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. For the most part, company management acts in an ethical manner.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

PERSONNEL POLICIES

10. My job responsibilities have been communicated to me.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
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ETHICAL VALUES	Strongly Disagree	Disagree	Neither Agree nor Disagree	Agree	Strongly Agree
11. I understand my job responsibilities.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
12. The criteria for assessing my performance have been communicated to me.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
13. The feedback I receive on my performance helps me improve.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
14. The information I need to perform my job is communicated to me					
• Accurately	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• In a timely fashion	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Completely	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
15. The training I receive helps me do a better job.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
16. I have been delegated the decision-making authority necessary to effectively perform my job.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
17. For the most part, I have been provided with the following resources necessary to perform my job effectively.					
• Budget/funding	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Personnel	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Supervisory guidance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

COMPANY VALUES

18. Please list the behaviors that are most frequently rewarded (see question 4 for example rewards). Example behaviors might include customer service, profit maximization, innovation, team building, cost reduction, or business expansion.

OTHER

19. Please comment on any other aspect of the company's culture or management policies that contributes to or detracts from your job responsibilities effectively. If a family member or friend were considering employment at ABC Company and asked, "What's it like working there?" how would you respond?

EVALUATION OF EMPLOYEE SURVEY RESULTS**INSTRUCTIONS**

The example employee survey groups questions into categories: company culture and personnel policies. However, note that question 14 also provides evidence of the operating effectiveness of the information and communication component of internal control. The survey is designed to gather information about the effectiveness of each of these entity-level controls in three different areas. These areas are

1. Awareness/understanding
2. Action
3. Attitude

The following form can be used to summarize the results of the survey. You should complete the form by

- Assigning a numeric value to each of the five possible responses, for example, “strongly agree” = 5, and “strongly disagree” = 1.
- Calculating an average value of the response for each question.
- Entering that average in the form in the space provided. Note that the form distinguishes the category (awareness, action, attitude) that the question was to address.

	Average Response		
	Awareness	Action	Attitude
Ethical Values			
1. I have read the company’s code of conduct.			
2. The company’s code of conduct helps me identify unacceptable business practices.			
3. If I observe unacceptable behavior on the job and report it to a member of the management team, I believe that the matter will be investigated.			
4. I believe that people who demonstrate a commitment to high ethical standards of behavior will be rewarded (e.g., through compensation or advancement).			
5. I believe that people who act in an unethical manner will be punished (e.g., through diminished compensation, lack of advancement, or termination).			
6. In the last three years, I have been asked by someone senior to me to take action that would be considered unethical.			
7. I know someone at the company who, in the last three years, has been asked by someone senior to them to take action that would be considered unacceptable.			
8. For the most part, company employees act in an ethical manner.			
9. For the most part, company management acts in an ethical manner.			

	Average Response		
	Awareness	Action	Attitude
Personnel Policies			
10. My job responsibilities have been communicated to me.			
11. I understand my job responsibilities.			
12. The criteria for assessing my performance have been communicated to me.			
13. The feedback I receive on my performance helps me improve.			
14. The information I need to perform my job is communicated to me <ul style="list-style-type: none"> • Accurately • In a timely fashion • Completely 			
15. The training I receive helps me do a better job.			
16. I have been delegated the decision-making authority necessary to effectively perform my job.			
17. For the most part, I have been provided with the following resources necessary to perform my job effectively. <ul style="list-style-type: none"> • Budget/funding • Personnel • Supervisory guidance 			

Index to Tests of Entity-Level Controls: Inspection of Documentation

PURPOSE

This form has been designed to

- Summarize the extent of your inspection of documents and map these tests to the entity-level controls to which they relate
- Provide a centralized cross-reference to the documentation of the procedures performed and test results for entity-level controls

INSTRUCTIONS

Provide a brief description of the document you inspected and enter this into the second column. In the first column, you should assign this item an identifying number as a way to cross-reference the reviewer to your description of the test performed and its results.

Check the appropriate boxes to indicate the entity-level control(s) to which the test relates. It is common for the inspection of one document to provide evidence about the operating effectiveness of more than one control.

To this index you should attach descriptions of the procedures performed and the results of those procedures. The form TST-ENT-4a may be used for this purpose. One form should be completed for each document or group of related documents reviewed.

Ref.	Description	Entity-Level Control									
		Control Environment		Risk Assess	Information and Communication	Monitor	Period-End Reporting	Select Accounting Policies	Audit Committee	Antifraud	Nonroutine Transactions
		Culture	Personnel								
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Worksheet to Document Inspection of Documentation of Performance of Entity-Level Controls

PURPOSE

This form has been designed to

- Facilitate your inspection of documentation that provides evidence of the performance of entity-level controls
- Document the work performed and conclusions reached regarding the inspection of the company's documentation

INSTRUCTIONS

This form should be used to document your inspection of documentation that provides evidence as to the performance of entity-level controls. The documentation of the performance of an entity-level control is different from the documentation of the control policy or procedure itself. Documentation of the company's stated entity-level control policies may be found on form DOC-1.

At the top right-hand corner, assign an identifying number to the form. This identifier should correspond to the reference number provided in the Index to Tests of Entity-Level Controls: Inspection of Documentation, form TST-ENT-4.

In the first part of the form, summarize the basic information about the document inspected. You then should indicate the entity-level control to which your test relates.

In part II of the form, you should describe the results of your tests that are relevant to assessing the operating effectiveness of the control tested. First, describe the evidence you observed that indicates that the control is operating as designed. Next, summarize any deviations from stated company policies. These testing deviations will be summarized and evaluated along with all other test results.

Footnoted comments in italics are additional instructions to the preparer of the form and should be removed before the form is considered final.

Reference No: _____

**ASSESSMENT OF INTERNAL CONTROL EFFECTIVENESS
INSPECTION OF DOCUMENTATION
OF CONTROL PERFORMANCE**

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

This form describes our inspection of relevant documentation indicating the performance of certain entity-level controls.

PART I: BASIC INFORMATION

Title of Document Reviewed _____

Document Prepared by _____

Date Document Prepared _____

Reference to Original Document _____

Purpose of Document or Summary of Contents

Test Objective

This document provides evidence about the operating effectiveness of the following entity-level control(s).¹

- | | |
|---|---|
| <input type="checkbox"/> Control environment | <input type="checkbox"/> Selection and application of accounting policies |
| <input type="checkbox"/> Risk assessment | <input type="checkbox"/> Audit committee oversight |
| <input type="checkbox"/> Information and communication | <input type="checkbox"/> Antifraud programs and controls |
| <input type="checkbox"/> Monitoring | <input type="checkbox"/> Nonroutine transactions |
| <input type="checkbox"/> Period-end financial reporting | |

¹Check all that apply.

PART II: SUMMARY OF RESULTS

My inspection of the document identified the following matters that are relevant to assessing the operating effectiveness of the above-indicated controls.

Evidence That Control Is Operating as Designed

Control Deviations

The document indicates the following deviations from stated company policies.

Index to Tests of Entity-Level Controls: Observation of Operations

PURPOSE

This form has been designed to

- Summarize the extent of your observation of operations and map these tests to the entity-level controls to which they relate
- Provide a centralized cross-reference to the documentation of the procedures performed and test results for entity-level controls

INSTRUCTIONS

Provide a brief description of the operation you observed and enter this into the second column. In the first column, you should assign this item an identifying number as a way to cross-reference the reviewer to your description of the test performed and its results.

Check the appropriate boxes to indicate the entity-level control(s) to which the test relates. It is common for the observation of one operation to provide evidence about the operating effectiveness of more than one control.

To this index you should attach descriptions of the procedures performed and the results of those procedures. The form TST-ENT-5a may be used for this purpose. One form should be completed for each operation or group of related operations made.

Ref.	Description	Entity-Level Control									
		Control Environment		Risk Assess	Information and Communication	Monitor	Period-End Reporting	Select Accounting Policies	Audit Committee	Antifraud	Nonroutine Transactions
		Culture	Personnel								
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Worksheet to Document Observation of Operation of Entity-Level Controls

PURPOSE

This form has been designed to

- Facilitate your observation of operations that provides evidence of the performance of entity-level controls
- Document the work performed and conclusions reached regarding the observation of operations

INSTRUCTIONS

This form should be used to document your observation of an operation that provides evidence as to the performance of entity-level controls. The documentation of the performance of an entity-level control is different from the documentation of the control policy or procedure itself. Documentation of the company's stated entity-level control policies may be found on form DOC-1.

At the top right-hand corner, assign an identifying number to the form. This identifier should correspond to the reference number provided in the Index to Tests of Entity-Level Controls: Observation of Operations, form TST-ENT-5.

In the first part of the form, summarize the basic information about the operation you observed, for example, a meeting of the audit committee or board of directors. You then should indicate the entity-level control to which your test relates.

In part II of the form, you should describe what you observed that is relevant to assessing the operating effectiveness of the control tested. First, describe the observations that indicate that the control is operating as designed. Next, summarize any deviations from stated company policies. These testing deviations will be summarized and evaluated along with all other test results.

Footnoted comments in italics are additional instructions to the preparer of the form and should be removed before the form is considered final.

Reference No: _____

**ASSESSMENT OF INTERNAL CONTROL EFFECTIVENESS
OBSERVATION OF OPERATIONS**

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

This form describes our observations of company operations related to the performance of certain entity-level controls

PART I: BASIC INFORMATION

Operation Observed _____

Person(s) Involved in the Operation _____

Date the Operation Was Performed _____

Brief Description of the Operation

Test Objective

This observation provides evidence about the operating effectiveness of the following entity-level control(s).¹

- | | |
|---|---|
| <input type="checkbox"/> Control environment | <input type="checkbox"/> Selection and application of accounting policies |
| <input type="checkbox"/> Risk assessment | <input type="checkbox"/> Audit committee oversight |
| <input type="checkbox"/> Information and communication | <input type="checkbox"/> Antifraud programs and controls |
| <input type="checkbox"/> Monitoring | <input type="checkbox"/> Nonroutine transactions |
| <input type="checkbox"/> Period-end financial reporting | |

¹Check all that apply.

PART II: SUMMARY OF RESULTS

My observation identified the following matters that are relevant to assessing the operating effectiveness of the above-indicated controls.

Evidence That Control Is Operating as Designed

I observed the following, which indicate that the control is operating as designed.

Control Deviations

I observed the following deviations from stated company policies.

Index to Tests of Entity-Level Controls: Reperformance of Controls

PURPOSE

This form has been designed to

- Summarize the extent of your reperformance of controls and map these tests to the entity-level controls to which they relate
- Provide a centralized cross-reference to the documentation of the procedures performed and test results for entity-level controls

INSTRUCTIONS

Provide a brief description of the control you reperfomed and enter this into the second column. In the first column, you should assign this item an identifying number as a way to cross-reference the reviewer to your description of the test performed and its results.

Check the appropriate boxes to indicate the entity-level control(s) to which the test relates. The reperformance of one control procedure may provide evidence about the operating effectiveness of more than one control.

To this index you should attach descriptions of the procedures performed and the results of those procedures. The form TST-ENT-6a may be used for this purpose. One form should be completed for each control or group of related controls reperfomed.

Ref.	Description	Entity-Level Control									
		Control Environment		Risk Assess	Information and Communication	Monitor	Period-End Reporting	Select Accounting Policies	Audit Committee	Antifraud	Nonroutine Transactions
		Culture	Personnel								
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Worksheet to Document Reperformance of Entity-Level Controls

PURPOSE

This form has been designed to

- Facilitate your reperformance of an entity-level control(s)
- Document the work performed and conclusions reached regarding the inspection of the company's documentation

INSTRUCTIONS

This form should be used to document your reperformance of an entity-level control(s). The documentation of the performance of an entity-level control is different from the documentation of the control policy or procedure itself. Documentation of the company's stated entity-level control policies may be found on form DOC-1.

At the top right-hand corner, assign an identifying number to the form. This identifier should correspond to the reference number provided in the Index to Tests of Entity-Level Controls: Reperformance of Controls, form TST-ENT-6.

In the first part of the form, summarize the basic information about the control you reperfomed. You then should indicate the entity-level control to which your test relates.

In part II of the form, you should describe the results of your tests that are relevant to assessing the operating effectiveness of the control tested. First, describe the evidence you observed that indicates that the control is operating as designed. Next, summarize any deviations from stated company policies. These testing deviations will be summarized and evaluated along with all other test results.

Footnoted comments in italics are additional instructions to the preparer of the form and should be removed before the form is considered final.

Reference No: _____

**ASSESSMENT OF INTERNAL CONTROL EFFECTIVENESS
REPERFORMANCE OF ENTITY-LEVEL CONTROL**

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

This form describes our reperformance of certain entity-level controls.

PART I: BASIC INFORMATION

Description of Control Procedure

Control Performed by _____

Date Control Performed _____

Description of Procedures to Reperform the Original Test

Test Objective

This test provides evidence about the operating effectiveness of the following entity-level control(s).¹

- ☐ Control environment
- ☐ Selection and application of accounting policies

¹Check all that apply.

- ☐ Risk assessment
- ☐ Information and communication
- ☐ Monitoring
- ☐ Period-end financial reporting
- ☐ Audit committee oversight
- ☐ Antifraud programs and controls
- ☐ Nonroutine transactions

PART II: SUMMARY OF RESULTS

My reperformance of the control identified the following matters that are relevant to assessing the operating effectiveness of the above-indicated controls.

Evidence That Control Is Operating as Designed

I obtained the following results, which indicate that the control is operating as designed.

Control Deviations

The results of my tests indicate the following deviations from stated company policies.

Work Program for Reviewing a Report on IT General Control Effectiveness

PURPOSE

This form has been designed to

- Facilitate the effective review of a specialist's report on IT general control operating effectiveness

INSTRUCTIONS

The testing of IT general control effectiveness requires specialized expertise. This work program assumes that the project team will engage an IT specialist to perform this work.

Engaging an IT specialist to test IT general controls does *not* relieve the project team of all responsibilities relating to IT controls. Although the IT specialist will have the primary responsibility for planning and performing the tests of controls and for discussing the results of these tests, the project team must assume the final responsibility for assessing IT control effectiveness. To fulfill this responsibility, the project team should obtain an understanding of the nature of the work performed by the IT specialist. Generally, this understanding should cover the following.

- The objective of the work
- The scope of the work
- The timing of the work
- The testing procedures and methods used
- The criteria used by the specialist to evaluate control testing exceptions, including a determination of the relative significance of any control deficiencies
- The form and content of the IT specialist's findings that will enable you to evaluate IT general control operating effectiveness

This work program is designed to help you meet these responsibilities.

Notations in italics are additional instructions to the preparer of the form and should be removed before the form is considered final.

REVIEW OF REPORT ON IT GENERAL CONTROL
OPERATING EFFECTIVENESS

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

This form summarizes the procedures we performed to understand and evaluate the work performed by an IT specialist to test and evaluate the operating effectiveness of IT general controls

Procedure Performed	N/A Performed by	Date	Notes
Planning			
1. Determine the IT systems that should be included within the scope of the testwork. Identify all elements of the systems including <ul style="list-style-type: none">• Hardware• Software• Data• Facilities			
2. Obtain a preliminary understanding of the IT general control objectives and control policies and procedures that should be included within the scope of the evaluations.			
3. Engage an IT specialist to plan, perform, assess, and report on the operating effectiveness of IT general controls.			
4. Obtain an understanding of the specialist's qualifications to perform the work. These qualifications may include <ul style="list-style-type: none">• Professional certification or licensing• Reputation and standing in the views of peers and others familiar with the specialist's capability or performance			

Procedure Performed	N/A Performed by	Date	Notes
<ul style="list-style-type: none"> • Experience in testing and reporting on IT general controls in conjunction with an overall evaluation of the effectiveness of internal control over financial reporting 			
5. Reach an understanding with the specialist regarding <ol style="list-style-type: none"> a. The objective of the work b. The scope of the work c. The general nature, timing, and extent of the testwork d. The criteria to be used to evaluate testing exceptions and control deficiencies e. The form and content of the report to be issued 			
Read and Understand Report			
Read and understand the IT specialist's report on IT general control effectiveness and evaluate the following.			
6. Assess the scope of the specialist's engagement and determine that the engagement included <ol style="list-style-type: none"> a. All IT systems that are part of the project team's internal control assessment project b. All control objectives that were previously determined to be evaluated in order to conclude on the overall effectiveness of internal control over financial reporting 			
7. Evaluate the date as of which control effectiveness was assessed and determine that this timing is suitable to evaluate overall internal control effectiveness as of year-end.			

Procedure Performed	N/A Performed by	Date	Notes
<p>a. If the timing of the tests of controls does not allow for a reasonable conclusion on the effectiveness of the company's internal control as of year-end, reach an understanding with the IT specialist about the nature, timing, and extent of tests necessary to update the conclusions on IT general control operating effectiveness.</p>			
<p>8. Understand the criteria used by the specialist to evaluate the significance of testing exceptions and control deficiencies. Reconcile these criteria to the definitions provided in PCAOB Auditing Standard No. 2 for (a) control deficiencies, (b) significant deficiencies, and (c) material weaknesses; and to the guidance provided in the answers to Q11–Q15 of PCAOB Staff Questions and Answers (June 23, 2004) and Q35 of PCAOB Staff Questions and Answers (November 22, 2004).</p>			
<p>9. Identify and assess the propriety of the specialist's conclusions regarding</p> <ul style="list-style-type: none"> a. Material weaknesses in IT general controls b. Significant control deficiencies c. Other control deficiencies d. Testing exceptions not considered to be indicative of a control deficiency e. The effect that identified IT general control deficiencies have on the operating effectiveness of associated application controls 			

Procedure Performed	N/A Performed by	Date	Notes
Conclude			
10. Summarize all control deficiencies, significant deficiencies, and material weaknesses (carry these forward to form ADM-3).			
11. Communicate findings to management and external auditors, as required.			
12. Plan and implement corrective action to address all control deficiencies, significant deficiencies, and material weaknesses.			
13. Identify compensating controls, if any, that address the same control objective(s) as the controls where deficiencies were determined to exist.			
14. Assess the impact that IT general control deficiencies (including those identified as significant or material weaknesses) will have on the following. a. The effectiveness of associated application controls b. Tests of activity-level controls c. Overall effectiveness of the company's internal control over financial reporting, after considering the effectiveness of any compensating controls			

Planning and Review of Scope of Tests of IT General Control Effectiveness

PURPOSE

This form has been designed to

- Help you plan the scope of the tests of operating effectiveness of IT general controls
- Review the report of the IT specialist to determine that the scope of tests was sufficient

INSTRUCTIONS

Determining an appropriate scope of tests for IT general controls involves two considerations

1. The IT systems that are to be tested
2. The control objectives for which controls should be tested

This form is divided into those two parts.

This form serves a dual purpose. First, you should complete the “Planning” columns of the form. This procedure will allow you to determine and document your assessment of the required scope of the work. You may wish to share this documentation with the IT specialist to avoid confusion.

Once the IT specialist has submitted his or her report, you should complete the “Review” columns of the form to indicate whether the item was included in the scope of the specialist’s testwork. Items that you had planned to be included in the scope but that were not are a testing deficiency that may preclude you from reaching a supportable conclusion on IT general control operating effectiveness.

Notations in italics are additional instructions to the preparer of the form and should be removed before the form is considered final.

**PLANNING AND REVIEWING SCOPE OF TESTS IT GENERAL
CONTROL OPERATING EFFECTIVENESS**

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

This form summarizes our determination of which IT systems and control objectives should be included within the scope of testwork for IT general controls operating effectiveness as well as our review of the adequacy of the scope of the work actually performed.

IT SYSTEMS

Name of System	Description	Planning		Review of Report	
		Include in Scope?		Included in Tests?	
		Yes	No	Yes	No
Financial accounting					
Hardware		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
OS software		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Application software		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other software (e.g., network, telecommunications)		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Data		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Facilities		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Name of System	Description	Planning		Review of Report	
		Include in Scope?		Included in Tests?	
		Yes	No	Yes	No
<i>Order processing and tracking</i>					
Hardware		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
OS software		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
Application software		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
Other software (e.g., network, telecommunications)		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
Data		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
Facilities		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
<i>Inventory management</i>					
Hardware		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
OS software		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
Application software		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>

Name of System	Description	Planning		Review of Report	
		Include in Scope?		Included in Tests?	
		Yes	No	Yes	No
Other software (e.g., network, telecommunications)		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Data		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Facilities		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

IT CONTROL OBJECTIVES

IT Control Objective	Planning		Review of Report	
	Include in Scope?		Included in Tests?	
	Yes	No	Yes	No
<i>Plan and Organize</i>				
Define a strategic IT plan.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Define the information architecture.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Determine technological direction.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Define the IT organization and relationships.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Manage the IT investment.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Communicate management aims and direction.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Manage human resources.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

IT Control Objective	Planning		Review of Report	
	Include in Scope?		Included in Tests?	
	Yes	No	Yes	No
Ensure compliance with external requirements.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Assess risks.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Manage projects.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Manage quality.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<i>Acquire and Implement</i>				
Identify automated solutions.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acquire and maintain application software.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acquire and maintain technology infrastructure.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Develop and maintain procedures.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Install and accredit systems.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Manage change.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<i>Deliver and Support</i>				
Define and manage service levels.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Manage third-party services.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Manage performance and capacity.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ensure continuous service.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ensure systems security.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Identify and allocate costs.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

IT Control Objective	Planning		Review of Report	
	Include in Scope?		Included in Tests?	
	Yes	No	Yes	No
Educate and train users.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Assist and advise customers.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Manage the configuration.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Manage problems and incidents.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Manage data.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Manage facilities.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Manage operations.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<i>Monitor and Evaluate</i>				
Monitor the processes.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Assess internal control adequacy.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Obtain independent assurance.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Provide for independent audit.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Guidelines for Testing Activity-Level Control Effectiveness¹

TEST DESIGN CONSIDERATIONS

Your tests of activity-level controls should allow you to gather sufficient evidential matter to support your conclusion about the effectiveness of internal control. To be “sufficient,” the evidence should be persuasive or convincing. A preponderance of the evidence gathered should support your conclusion about control effectiveness. The evidence does not have to be incontrovertible to support your conclusion. You do not have to prove your point beyond a shadow of a doubt.

Your tests of operating effectiveness should be designed to determine

- How the control procedure was performed
- The consistency with which it was applied
- By whom it was applied

Nature, Timing, and Extent of Tests

NATURE

You will need to decide on the types of tests you will perform. For example, will you conduct inquiries, observe controls being performed, or reperform certain control procedures? The nature of the tests you perform depends on the type of control procedure being tested and whether its performance is documented.

Typically, you will perform a combination of one or more tests in order to gather evidence about control effectiveness. It would be unlikely that one test will give you all the evidence needed to support your conclusion. For example, suppose you observe the operation of a control procedure such as an edit check on the electronic input of information. You observe the control to be functioning properly, but how do you know that the control was in place and operating effectively throughout the reporting period? Your observation will have to be supplemented with other procedures, such as inquiry.

When determining the nature of the tests you will perform to support your conclusion,

¹This material was originally published in a slightly different format in *How to Comply with Sarbanes-Oxley Section 404: Assessing the Effectiveness of Internal Control*, by Michael Ramos, published by John Wiley & Sons, 2004, pages 209–221.

consider that your opinion most likely will be formed by the congruence and consistency of the evidence you gather from several sources and types of tests.

TIMING

The Sarbanes-Oxley Act requires management to report on the effectiveness of internal control as of a point in time, namely, year-end. As a practical matter, you most likely will perform many of your tests in advance of the reporting date. When you do, you must consider the need to perform additional tests to establish the effectiveness of the control procedure from the time the tests were performed until year-end. For example, if you tested the effectiveness of bank reconciliations as of June 30 and the reporting date was December 31, you will need to consider performing tests to cover the period from July 1 through December 31. These tests may not require you to repeat the detailed tests performed at June 30 for the subsequent six-month period. If you establish the effectiveness of the control procedure at June 30 you may be able to support a conclusion about the effectiveness of the control at the reporting date indirectly through the consideration of entity-level controls and other procedures such as

- The effectiveness of personnel-related controls such as the training and supervision of personnel who perform control procedures. For example, are the people performing the bank reconciliations adequately supervised, and was their work reviewed during the second half of the year?
- The effectiveness of risk identification and management controls, including change management. For example, would management be able to identify changes in the entity's business or its circumstances that would affect the continued effectiveness of bank reconciliations as a control procedure?
- The effectiveness of the monitoring component of the entity's internal control.
- Inquiries of personnel to determine what changes, if any, occurred during the period that would affect the performance of controls.
- Repeating the procedures performed earlier in the year, focusing primarily on elements of the control procedure that have changed during the period. For example, if the entity added new bank accounts or new personnel performing certain bank reconciliations, you would focus your tests on those accounts and individuals.

Computer Application Controls

The COSO report describes two different levels of computer controls: general and application-specific. Application controls are the structure, policies, and procedures that apply to separate, individual business process application systems. They include both the automated control procedures (i.e., those routines contained within the computer program) and the policies and procedures associated with user activities, such as the manual follow-up required to investigate potential errors identified during processing.

As with all other control procedures, computer application controls should be designed to achieve specified control objectives, which in turn are driven by the risks to achieving certain business objectives. In general, the objectives of a computer application are to ensure that

- Data remain complete, accurate, and valid during their input, update, and storage
- Output files and reports are distributed and made available only to authorized users

Specific application-level controls should address the risks to achieving these objectives. The following exhibit provides examples of computer application control objectives and related controls.

Example Computer Application Control Objectives and Controls	
Control Objective	Control Activity
<i>Authorization</i>	
All application users are appropriately identified and authenticated.	<ul style="list-style-type: none">• Passwords and personal identification numbers• “Nonrepudiation” that prevents senders and receivers of information from denying that they sent or received the information• Emerging technologies such as digital certificates or smart cards
Access to the application and related data files is restricted to authorized users for authorized purposes.	<ul style="list-style-type: none">• Logical access control system restricts access to the application and data to authorized users.• Firewalls protect application and data from unauthorized use.• Terminals automatically disconnect from the system when not used after a specified period of time.• Computer equipment is located in physically secure locations.
All data are authorized before entering the application.	<ul style="list-style-type: none">• Critical input information is tested against predefined criteria. All exceptions are reviewed by an individual with the proper authority to approve them.• Paper-based information is reviewed and approved prior to input.
<i>Completeness</i>	
All authorized data enter and are processed by the application.	<ul style="list-style-type: none">• Transactions are numbered prior to entry; sequence is checked periodically.• Control totals, hash totals, and record counts ensure that all data are processed.

	<ul style="list-style-type: none"> • Transaction data are matched with data in a master or suspense file. Unmatched items from both the transaction data and master or suspense files are reported for investigation.
<i>Accuracy</i>	
Date entry design features contribute to data accuracy.	<ul style="list-style-type: none"> • Preformatted screens and menu-driven input • Electronic input of information
Data validation and editing are performed to identify erroneous data.	<ul style="list-style-type: none"> • Automated validation and edit checks
Erroneous data are captured, reported, investigated, and corrected.	<ul style="list-style-type: none"> • Suspense files capture and control errors. • Suspense files are regularly reviewed and items are appropriately resolved.
<i>Confidentiality</i>	
Access to application output is restricted to authorized users.	<ul style="list-style-type: none"> • Access to confidential information is limited to authorized individuals consistent with the entity's confidentiality policies. • Data encryption technologies protect the transmission of user authentication, verification, and confidential information.

The way in which computer control objectives are met will depend on the types of technologies used by the entity. For example, the specific control procedures used to control access to an online, real-time database will be different from those procedures related to access of a "flat file" stored on a disk.

An IT controls specialist most likely will be needed to understand the risks involved in various technologies and the related activity-level controls.

Considering the Results of Entity-Level Tests

Entity-level controls affect the operational effectiveness of activity-level controls. For example, the entity may have thorough, well-designed controls to ensure a proper sales cut-off at year-end (activity-level control), but if they do a poor job of communicating and monitoring the performance of the people responsible for performing the procedure (an entity-level control), then ultimately the control will lack full effectiveness. When designing your activity-level tests, your conclusions about the effectiveness of entity-level controls

should be used in two ways. First, plan your activity-level tests to gather firsthand information about the effectiveness of entity-level controls. Use this information to (hopefully) corroborate your earlier assessment of entity-level control effectiveness.

For example, when making inquiries of an individual about the control procedures he or she performs, consider expanding your inquiries to include questions about entity-level controls. Examples of inquiries that go beyond understanding activity-level control procedures include the following:

- If changes to your procedures were required, how would they be communicated?
- What kind of on-the-job or formal classroom training do you receive? Do you find it helpful?
- How closely is your work supervised?
- If any problems or errors that you can't fix are identified, do you ever get the impression that they are either ignored or "made to go away" without being adequately addressed?

The second way in which entity-level controls affect the design of activity-level controls is in the scope of your testwork. Weaknesses in entity-level controls should lead you to expand the scope of your activity-level testing. Conversely, strengths in entity-level controls may allow you to reduce the scope of activity-level tests.

For example, consider two companies, both in the same industry. Revenue is a significant activity, and the 10-Ks for both entities identify revenue recognition as a critical accounting policy. However, their entity-level controls have significant differences, as indicated in the following table.

Example Entity-Level Controls	
Company A	Company B
<ul style="list-style-type: none">• Management and employee incentives are based exclusively on profitability.• The company has a highly competitive "up-or-out" culture.• Communication and training of employees generally are poor.• Oversight and supervision are lax.	<ul style="list-style-type: none">• Incentives are based on profitability plus "balanced scorecard" financial and nonfinancial metrics such as customer satisfaction and product quality.• The culture is built on product innovation and customer service.• There are formal training methods for communicating policies and acceptable behavior.• There is effective oversight and supervision.

In the case of company A, you would want to expand the scope of your activity-level testwork for processing revenue transactions. For example, if your tests included transaction testing, you would increase your sample size. Inquiries might be made of more individuals or people you otherwise would not consider interviewing. You may even expand your procedures to include divisions or locations you otherwise would not consider. For company B, the opposite is true.

Additionally, the relative strength of entity-level controls should be considered when you plan the timing of your procedures. With company B, where entity-level controls are

strong, you may be able to test the activity-level controls well in advance of the reporting date and place reliance on entity-level controls to draw a conclusion about operating effectiveness at the reporting date. With company A, you probably will have to adopt a different strategy, for example, testing the controls closer to the reporting date or reperforming a limited number of activity-level tests near the reporting date.

TYPES OF TESTS

Walkthroughs and Inquiries

A walkthrough is a procedure in which you trace a transaction from its origination through the company's information processing system and all the way to its reporting in the financial statements. Although inquiries of company personnel are a major component, a walkthrough is more than just inquiry. Walkthroughs and formal inquiries of entity personnel—either individually or as part of a focus group—can be a reliable source of evidence about the operating effectiveness of activity-level controls. Walkthroughs can serve two main purposes:

1. To confirm your understanding of the design of the control (what should happen)
2. To identify exceptions to the entity's stated control procedures (what really happens)

It is best to perform walkthroughs of major transactions first, before performing other tests of operating effectiveness.

Form TST-ACT-1 provides guidance and suggestions for performing walkthroughs and inquiries.

Tests of Transactions

Some control procedures allow you to select a sample of transactions that were recorded during the period and

- Examine the documentation indicating that the control procedure was performed
- Reperform the procedure to determine that the control was performed properly

For example, the process for recording inventory purchases may require

- Physically matching a paper-based warehouse receiving report with an approved purchase order
- Determining that the purchase order was properly approved, as indicated by a signature
- Determining that the vendor is an approved vendor
- Observing evidence (e.g., checkmarks, initials) that warehouse personnel counted the goods received

To test the effectiveness of this control procedure you could

- Examine documentation that the control was performed, including that
 - Documents were matched
 - Purchase order was signed
 - Receiving report was marked

- Determine that the control was performed properly, including that
 - Purchase order and receiving report are for the same transaction
 - Vendor is an approved vendor
 - Signer of the purchase order has the authority to approve the transaction

Computer application controls also may lend themselves to similar testing techniques. For example, suppose that purchased goods are accompanied with a bar code that identifies the goods received and their quantities. The bar code is scanned, and the information is matched electronically to purchase order files and approved vendor master files. Unmatched transactions are placed in a suspense file for subsequent follow-up. (As indicated previously, the computer application control consists of both the programmed elements of the control and the manual follow-up of identified errors.) To test the effectiveness of this control, you could

- Prepare a file of test transactions and run through the system to determine that all errors are identified
- Review the resolution of the suspense account items performed throughout the period to determine that they were resolved properly

When performing tests of transactions, you will have to address issues related to scope—how many items to test.

Before performing your tests of transactions you also should define what you will consider a control procedure error. In instances in which the evidence of performing the procedure is documented (e.g., an initial or signature), the lack of documentation (a missing signature), should be considered an error in the operation of the control. That is, in order for a documented control to be considered properly performed, both of the following must be true:

- The documentation indicates that the control procedure was properly performed.
- Your reperformance of the procedures indicates it was performed properly.

Testing Reconciliations

Reconciliations are a common control procedure, for example, bank reconciliations or the reconciliation of the general ledger account total to a subsidiary ledger. In some instances, a well-designed reconciliation can provide an effective control over the majority of a processing stream. Testing the effectiveness of a reconciliation is similar to tests of transactions:

- Review documentation that the test was performed on a timely basis throughout the period.
- Reperform the test to determine that all reconciling items were identified properly.
- Investigate the resolution of significant reconciling items.

Observation

You may be able to observe the application of some control procedures, such as computer input controls like edit checks. A physical inventory count also lends itself to observation

as a means of assessing effectiveness. For a control performed only occasionally, such as a physical count, it may be possible to observe the control each time it is performed. For controls that are performed continuously for large volumes of transactions, you will need to supplement your observations with other tests such as

- Inquiry
- Tests of entity-level controls

Guidelines and Example Inquiries for Performing Walkthroughs

PURPOSE

This form has been designed to

- Provide suggestions and example inquiries to help you perform more effective walk-through procedures
- Document the procedures performed and information gathered as a result of walk-through procedures

INSTRUCTIONS

What's a Walkthrough?

A walkthrough is a procedure in which you trace a transaction from its origination through the company's information processing system, and all the way to its reporting in the financial statements. Although inquiries of company personnel are a major component, a walkthrough is more than just inquiry. Think of a walkthrough as

- *Corroborative inquiry*, in which you ask questions of client personnel and then obtain corroborating evidence to support their answers
- *A test of one*, in which you take a single transaction and perform detailed procedures to test the operating effectiveness of the controls for processing that transaction

The company is not required to perform walkthrough procedures; however, it is in management's best interests to do so.

Sometimes, the company's documentation of its information processing stream does not match the reality of what actually happens on a daily basis. Companies that perform tests of controls based only on what has been documented often run into testing exceptions when they discover that documentation of the information stream and related controls was not accurate.

The walkthrough procedure will allow you to confirm your understanding of key elements of the information processing stream and related controls *before* you begin detailed testwork. The walkthrough can help you evaluate the effectiveness of the design of internal control for each major transaction. While performing your walkthrough, you also may obtain evidence about the operating effectiveness of controls.

Updating the Walkthrough

Walkthrough procedures should continue to be relevant as long as there are no significant changes to the information processing stream. When significant changes do occur, you should update your walkthrough to confirm your understanding of the new processing and control procedures.

Special Considerations for External Auditors

PCAOB Auditing Standard No. 2 requires external auditors to perform at least one walkthrough for each major class of transaction. Further, the external auditor is prohibited from relying on the work of management or others to perform the walkthroughs. Paragraphs 79 through 82 of Auditing Standard No. 2 provide further directions to auditors on the objectives, scope, and procedures to be performed when conducting a walkthrough.

Suggestions Included on This Form

This form includes three separate sections:

1. *Guidelines for performing effective walkthroughs.* Because management is not required to perform walkthroughs, these guidelines are suggestions only. You may use these suggestions to help you plan more effective walkthroughs. (For external auditors, some of these “guidelines” are required by the auditing standards.)
2. *Example inquiries.* Inquiries of business process owners and other company personnel are an important component of the walkthrough procedure. Use these example inquiries to help you gain a better understanding of transaction processing and the related controls.
3. *Walkthrough documentation.* This form may be used to document the procedures performed, information gathered, and conclusions reached as a result of your walkthroughs. The form has been designed for you to fill out for each person interviewed during your walkthroughs.

GUIDELINES FOR PERFORMING EFFECTIVE WALKTHROUGHS

PLANNING THE WALKTHROUGH

- Plan on performing one walkthrough for each of the company’s major transactions.
- Your walkthrough should encompass the entire scope of the transaction, including the processing and control of the transaction’s
 - Initiation
 - Authorization

- Recording in the company's books and records
- Processing of accounting information
- Reporting in the financial statements
- It is typical to start your walkthrough at the initiation of the transaction and work forward.
- Plan on identifying the authorization control at the point where the transaction is initiated.
- Plan your procedures to identify and confirm other controls at each major processing step.
- As part of your walkthrough, you should evaluate whether there is adequate segregation of duties.

MAKING INQUIRIES

- Make inquiries of the people who actually perform control procedures and process information as part of their daily job requirements. Don't limit your inquiries to those who supervise or review the process or are otherwise a step or two removed from actually performing the work. Talk to people in operations, outside of management, and outside of the accounting department.
- Design your inquiries to obtain information about the person's understanding of
 - What is required by the company's prescribed procedures and controls
 - Whether the procedures are performed as described and on a timely basis
- Ask questions to identify specific situations (which may occur regularly) in which personnel do not perform the control procedures as described in the company's internal control documentation.
- Consider conducting inquiries with a focus group, rather than one-on-one interviews.

OBTAINING SUPPORTING, CORROBORATING INFORMATION

- Corroborate answers received to your inquiries by
 - Asking the individual to demonstrate the performance of the procedure they are describing
 - Using the same documents and information technology ("live data") that company personnel use to perform the procedures
 - Asking other individuals to describe their understanding of the previous and succeeding processing or control activities

EVALUATE RESULTS OF WALKTHROUGH

- Use the results of your walkthrough to plan detailed tests of operating effectiveness. If necessary, make changes to the company's documentation of internal controls to reflect actual practice, as identified in your walkthrough.

EXAMPLE INQUIRIES

INQUIRY OBJECTIVES

To perform an effective walkthrough procedure, you should make inquiries of company personnel who are directly involved with each point in the processing of a transaction where important processing or controls occur. Your inquiries should be designed to obtain information about the person's understanding of

- What is required by the company's prescribed procedures and controls
- Whether the procedures are performed as described and on a timely basis

EXAMPLE QUESTIONS

To perform more effective walkthroughs, consider asking the following questions.

Nature of Procedures Performed

- Describe the procedures you perform related to the [initiation/authorization/recording/processing] of the transaction.
- How often are the procedures performed?
- When are the procedures required to be completed?
- From whom or from what electronic files do you receive the information to perform your procedures?
- To whom do you pass the results of the procedures?

Nature of Controls and Performance of Control Procedures

- During the performance of your procedures, what controls exist to ensure that the procedures were performed properly? For example, how do you know that
 - All data were processed
 - The data were processed accurately
 - No unauthorized transactions or data entered into the processing
- What do you look for to determine if there has been a processing error?
- What do you do when you find an error?

Deviations from Procedures and Processing Errors

- Under what circumstances are you required to deviate from the documented procedures?
- How often do these circumstances arise? How often have they arisen during the past year?

- What kind of errors have you found in the past year?
- What happened as a result of finding the errors? How were they resolved?

Confirm Understanding of Other Processing Steps

- What procedures are performed on the data prior to your receiving it?
- What procedures are performed on the data after you are done with it?

DOCUMENTATION OF WALKTHROUGH PROCEDURES

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

The following documents the procedures performed, information gathered, and conclusions reached relating to walkthroughs of major transactions.

PLANNING

Person we interviewed _____

Date of interview _____

Description of transaction discussed _____

Processing step(s) we discussed:

- ☐ Initiation of transaction
- ☐ Authorization of transaction
- ☐ Transaction recording
- ☐ Transaction processing steps

Brief description of the company’s prescribed processes and controls for the preceding step(s)

Assess the adequacy of the segregation of duties for the prescribed processes and controls, as described. If segregation of duties is not adequate, describe compensating controls.

PROCEDURES PERFORMED AND RESULTS

Nature of Controls and Performance of Control Procedures

We made inquiries of the individual identified in part I of this form to obtain his or her understanding of processing procedures and controls. We determined that the individual’s understanding was consistent with the company’s prescribed policies and procedures for each of the following items.

	Individual’s understanding is consistent with prescribed procedures and controls	
	Yes	No
Processing procedures to be performed	<input type="checkbox"/>	<input type="checkbox"/>
Control activities	<input type="checkbox"/>	<input type="checkbox"/>
Definition of a processing error	<input type="checkbox"/>	<input type="checkbox"/>
Procedures for reporting or correcting errors	<input type="checkbox"/>	<input type="checkbox"/>

Deviations from Prescribed Procedures

We identified the following circumstances under which the individual deviates from the company’s prescribed procedures.

Identification and Resolution of Processing Errors

The individual we interviewed described the following types of processing errors that were discovered during the past year and how these errors were resolved.

Corroborating Support

We performed the following procedures, as indicated, to corroborate the responses to our inquiries.

Procedure	Procedure Performed?		Comments
	Yes	N/A	
Reviewed original documents	<input type="checkbox"/>	<input type="checkbox"/>	
Made observations	<input type="checkbox"/>	<input type="checkbox"/>	
Received responses to inquiries made of others	<input type="checkbox"/>	<input type="checkbox"/>	
Performed other procedures	<input type="checkbox"/>	<input type="checkbox"/>	

Assessment of Results of Walkthrough Procedures

We have considered the results of the walkthrough procedures in designing the tests of operating effectiveness and, if necessary, evaluating the adequacy of the company's documentation of internal control, as described below.

Example Testing Program for Activity-Level Tests of Control

PURPOSE

These forms have been designed to provide examples of

- The links between financial reporting objectives, risks to those objectives, and control activities
- Tests of the operating effectiveness of activity-level controls

INSTRUCTIONS

The example testing programs in this section cover the following business activities that are common for many entities, including

- Revenue
- Purchases and expenditures
- Cash receipts and disbursements
- Payroll

These example programs are, by necessity, relatively generic and should be modified to fit the particular controls at your company.

To make this modification easier, the example testing procedures are linked not only to the example controls, but also to the overriding control objectives and risks to achieving those objectives. Control activities will vary greatly between companies, but it is anticipated that many entities will share common control objectives and related risks to achieving those objectives. Thus, in modifying these example programs, look first to control objectives that are comparable to the control objectives at your company. You then should be able to modify the example test procedures so that they are relevant and applicable to the way in which individual control activities are administered and documented at your company.

Note: Prior to modifying the example testing program, you should consider performing walkthrough procedures to confirm your understanding of the processing steps and related controls. Walkthrough procedures also include

- Inquiries of relevant personnel to determine if they have knowledge of any known departures from prescribed procedures and controls
- The assessment of the adequacy of the segregation of duties

Form TST-ACT-1 provides guidelines and examples for performing walkthrough procedures.

Example Testing Program for Control Operating Effectiveness: Revenue

PURPOSE

This form provides an example testing program that links the tests of operating effectiveness of activity-level controls to related controls, control objectives, and risks to achieving those objectives. Use this form to help you design tests of activity-level controls at your organization.

INSTRUCTIONS

To modify these example testing programs to fit the particular circumstances of your company, you should first identify the control objectives that are comparable to the control objectives at your company. Identify the control procedures in place to satisfy those objectives and which of those control procedures are most important in the prevention or detection of material misstatements. Using the example tests as a guide, design your own tests of operating effectiveness that are appropriate for the controls in place at the company.

You also should identify control objectives relevant to your company that are not included in the example testing program. Identify the control procedures related to these objectives, determine which of these procedures should be tested, and design the appropriate test.

Objective and Risk	Example Controls	Example Tests of Operating Effectiveness
Control Objective: Process only valid customer orders.		
Risk to Achieving Objective		
<ul style="list-style-type: none"> Customer orders may not be authorized. 	<ul style="list-style-type: none"> Verify appropriate marketing/sales personnel–approved customer order. 	<ul style="list-style-type: none"> Obtain a file of sales made during the period. Select a sample of transactions and examine customer order to determine that the transaction was authorized properly.
Control Objective: All goods shipped are accurately billed in the proper period.		
Risks to Achieving Objective		
<ul style="list-style-type: none"> Missing documents or incorrect information 	<ul style="list-style-type: none"> Use standard shipping or contract terms. Communicate nonstandard shipping or contract terms to accounts receivable. Verify shipping or contract terms before invoice processing. 	<ul style="list-style-type: none"> Inspect standard contracts with customers and shippers. Inspect evidence documenting the communication of nonstandard sales or shipping terms to accounting department personnel. Obtain a file of invoices processed during the period. Select a sample of transactions and examine the executed sales contract and shipping documents supporting the sale.

Objective and Risk	Example Controls	Example Tests of Operating Effectiveness
<ul style="list-style-type: none"> Improper cutoff of shipments at the end of a period 	<ul style="list-style-type: none"> Identify shipments as being before or after period-end by means of a shipping log and prenumbered shipping documents. Reconcile goods shipped to goods billed. 	<ul style="list-style-type: none"> Obtain the shipping log and select a sample of shipments. Ensure information reported on the shipping log agrees with the supporting shipping documents. Obtain the company's periodic reconciliations of goods shipped to goods billed. For a sample of reconciliations, reperform the procedures or otherwise determine that the procedures were performed properly.
Control Objective: Accurately record invoices for all authorized shipments and only for such shipments.		
Risk to Achieving Objective	<ul style="list-style-type: none"> Missing documents or incorrect information 	<ul style="list-style-type: none"> Obtain files of shipping documents and sales invoices processed during the period. Identify and account for all gaps in sequencing. Select a sample of invoices processed during the period and examine the underlying shipping documents or shipping log to determine that shipping date information is correct. Obtain a file of all unmatched orders, shipping documents, and invoices that were identified during the period. Select a sample of items and determine that they were resolved appropriately. Review communications received from customers and identify indicators of possible control deficiencies.

Objective and Risk	Example Controls	Example Tests of Operating Effectiveness
Control Objective: Accurately record all authorized sales returns and allowances and only such returns and allowances.		
Risks to Achieving Objective		
<ul style="list-style-type: none"> Missing documents or incorrect information 	<ul style="list-style-type: none"> Authorize credit memos by individuals independent of accounts receivable function. Prenumber and account for credit memos and receiving documents. Match credit memos and receiving documents and resolve unmatched items by individuals independent of the accounts receivable function. 	<ul style="list-style-type: none"> Obtain a file of credit memos processed during the period and <ul style="list-style-type: none"> Select a sample and determine that <ul style="list-style-type: none"> The credit memo was authorized properly Key information on the credit memo agrees with the related receiving report Identify and account for gaps in sequencing Review communications received from customers and identify indicators of possible control deficiencies. Observe operation of data input controls, such as edit checks.
<ul style="list-style-type: none"> Inaccurate input of data 	<ul style="list-style-type: none"> Mail customer statements periodically and investigate and resolve disputes or inquiries, by individuals independent of the invoicing function. 	
Control Objective: Ensure continued completeness and accuracy of accounts receivable.		
Risk to Achieving Objective		
<ul style="list-style-type: none"> Unauthorized input for nonexistent returns, allowances, and write-offs 	<ul style="list-style-type: none"> Review correspondence authorizing returns and allowances. Reconcile accounts receivable subsidiary ledger with the sale and cash receipts transactions. 	<ul style="list-style-type: none"> Obtain a file of returns, allowances, and other credits to accounts receivable that were posted during the period. Select a sample of entries and determine that the transaction was authorized properly.

Objective and Risk	Example Controls	Example Tests of Operating Effectiveness
<ul style="list-style-type: none"> Unauthorized access to accounts receivable records and stored data 	<ul style="list-style-type: none"> Resolve differences between the accounts receivable subsidiary ledger with the accounts receivable subsidiary ledger and the accounts receivable control account. 	<ul style="list-style-type: none"> Obtain the company's periodic reconciliation of the accounts receivable general ledger control account. For a sample of reconciliations, reperform the procedures or otherwise determine that the procedures were performed properly.
Control Objective: Safeguard accounts receivable records.		
Risk to Achieving Objective		
<ul style="list-style-type: none"> Unauthorized access to accounts receivable records and stored data 	<ul style="list-style-type: none"> Restrict access to accounts receivable files and data used in processing receivables. 	<ul style="list-style-type: none"> Test logical access to accounts receivable and data files used in processing receivables as part of the tests of IT general controls.

Example Testing Program for Control Operating Effectiveness: Purchases and Expenditures

PURPOSE

This form provides an example testing program that links the tests of operating effectiveness of activity-level controls to related controls, control objectives, and risks to achieving those objectives. Use this form to help you design tests of activity-level controls at your organization.

INSTRUCTIONS

To modify these example testing programs to fit the particular circumstances of your company, you should first identify the control objectives that are comparable to the control objectives at your company. Identify the control procedures in place to satisfy those objectives and which of those control procedures are most important in the prevention or detection of material misstatements. Using the example tests as a guide, design your own tests of operating effectiveness that are appropriate for the controls in place at the company.

You also should identify control objectives relevant to your company that are not included in the example testing program. Identify the control procedures related to these objectives, determine which of these procedures should be tested, and design the appropriate test.

Objective and Risk	Example Controls	Example Tests of Operating Effectiveness
Control Objective: Accurately record invoices on a timely basis for accepted purchases that have been authorized and only for such purchases.		
Risks to Achieving Objective		
<ul style="list-style-type: none"> • Missing documents or incorrect information 	<ul style="list-style-type: none"> • Prenumber and account for purchase orders and receiving reports. • Match invoice, receiving, and purchase order information and follow up on missing or inconsistent information. • Follow up on unmatched open purchase orders, receiving reports and invoices and resolve missing, duplicate, or unmatched items, by individuals independent of purchasing and receiving functions. 	<ul style="list-style-type: none"> • Obtain a file of purchase orders and receiving reports. Identify and account for all gaps in sequencing. • Obtain a file of all purchases processed during the period. Select a sample and determine that key information on the vendor invoice, receiving report, and company purchase order are in agreement. • Obtain a file of all unmatched purchase orders, receiving reports and vendor invoices that were identified during the period. Select a sample of items and determine that they were resolved appropriately.
<ul style="list-style-type: none"> • Inaccurate input of data • Invalid accounts payable fraudulently created for unauthorized or nonexistent purchases 	<ul style="list-style-type: none"> • Use control totals or one-for-one checking. • Restrict ability to modify data. • Reconcile vendor statements to accounts payable items. • Maintain physical security of purchase orders. 	<ul style="list-style-type: none"> • Observe operation of data input controls, such as data checks. • Obtain a file of approved vendors. Select a sample of vendors and examine supporting documentation indicating that vendor was properly approved. • Test logical access to accounts payable files and related data as part of the tests of IT general controls. • Select a sample of vendor statements received during the period. Determine that statements were reconciled properly to the company's accounts payable records. • Observe operation of controls to restrict physical access to unused purchase orders.

Control Objective: Accurately record returns and allowances for all authorized credits, and only for such credits.	
Risks to Achieving Objective	
<ul style="list-style-type: none"> • Missing documents or information 	<ul style="list-style-type: none"> • Prenumber and account for shipping orders for returned goods. • Match shipping orders for returned goods with vendors' credit memos. • Follow up on unmatched shipping orders for returned goods and related receiving reports and invoices and resolve missing, duplicate, or unmatched items, by individuals independent of accounts payable function. • Review vendor correspondence authorizing returns and allowances.
<ul style="list-style-type: none"> • Inaccurate input of data 	<ul style="list-style-type: none"> • Obtain a file of shipping orders for returned goods. Identify and account for all gaps in sequencing. • Obtain a file of all purchase returns processed during the period. Select a sample and determine that key information on the vendor credit memo and company shipping order are in agreement. • Obtain a file of all unmatched shipping orders for returned goods. Select a sample of items and determine that they were resolved appropriately. • Review vendor correspondence for indications of possible control deficiencies.
<ul style="list-style-type: none"> • Inaccurate input of data 	<ul style="list-style-type: none"> • Select a sample of vendor statements received during the period. Determine that statements were reconciled properly to the company's accounts payable records. • Observe operation of data input controls, such as data checks.
Control Objective: Ensure completeness and accuracy of accounts payable.	
Risks to Achieving Objective	
<ul style="list-style-type: none"> • Unauthorized input for nonexistent returns 	<ul style="list-style-type: none"> • Obtain the files of the company's accounts payable subsidiary ledger and the cash disbursements register. Reconcile all payments recorded in the accounts payable subsidiary ledger to the vendor payments recorded in the cash disbursements journal. Determine that the company identified and resolved properly all reconciling items identified in your test.

Objective and Risk	Example Controls	Example Tests of Operating Effectiveness
Control Objective: Ensure completeness and accuracy of accounts payable.		
Risks to Achieving Objective		
<ul style="list-style-type: none">Unauthorized additions to accounts payable	<ul style="list-style-type: none">Resolve differences between the accounts payable subsidiary ledger and the accounts payable control account.	<ul style="list-style-type: none">Obtain the company's periodic reconciliation of the accounts payable subsidiary ledger to the accounts payable general ledger control account. For a sample of reconciliations, reperform the procedures or otherwise determine that the reconciliation was performed properly.
Control Objective: Safeguard accounts payable records.		
Risks to Achieving Objective		
<ul style="list-style-type: none">Unauthorized access to accounts payable records and stored data	<ul style="list-style-type: none">Restrict access to accounts payable and files used in processing payables.Restrict access to mechanical check signers and signature plates.	<ul style="list-style-type: none">Test logical access to accounts payable and data files used in processing payables as part of the tests of IT general controls.Observe the controls in place to restrict physical access to mechanical check signers and signature plates.

Example Testing Program for Control Operating Effectiveness: Cash Receipts and Disbursements

PURPOSE

This form provides an example testing program that links the tests of operating effectiveness of activity-level controls to related controls, control objectives, and risks to achieving those objectives. Use this form to help you design tests of activity-level controls at your organization.

INSTRUCTIONS

To modify these example testing programs to fit the particular circumstances of your company, you should first identify the control objectives that are comparable to the control objectives at your company. Identify the control procedures in place to satisfy those objectives and which of those control procedures are most important in the prevention or detection of material misstatements. Using the example tests as a guide, design your own tests of operating effectiveness that are appropriate for the controls in place at the company.

You also should identify control objectives relevant to your company that are not included in the example testing program. Identify the control procedures related to these objectives, determine which of these procedures should be tested, and design the appropriate test.

Objective and Risk	Example Controls	Example Tests of Operating Effectiveness
Control Objective: Record cash receipts on accounts receivable completely and accurately.		
Risks to Achieving Objective	<ul style="list-style-type: none"> • Cash received is diverted, lost, or otherwise not reported accurately to accounts receivable. • Receipts are for amounts different from invoiced amounts, or are not identifiable. 	<ul style="list-style-type: none"> • Obtain the files of the company's cash receipts and accounts receivable subsidiary ledger. Reconcile all payments received recorded in the accounts receivable ledger to vendor cash receipts recorded in the cash accounts. Determine that company personnel identified and resolved properly all reconciling items identified in your test. • Read correspondence from customers and identify indications of potential control deficiencies. Assess whether company personnel follow-up on these potential deficiencies was appropriate. • Obtain the company's periodic reconciliation of the accounts receivable subsidiary ledger to the accounts receivable general ledger control account. For a sample of reconciliations, reperform the procedures or otherwise determine that the reconciliation was performed properly.
Control Objective: Disburse cash only for authorized purchases.		
Risks to Achieving Objective	<ul style="list-style-type: none"> • Fictitious documentation is created. • Examine supporting documents, payments approved by individuals independent of procurement, receiving, and accounts payable. • Obtain a file of all cash disbursement processed during the period. Select a sample and examine the underlying supporting documents to determine that purchase was properly authorized. 	

<ul style="list-style-type: none"> • Reuse of supporting documents 	<ul style="list-style-type: none"> • Cancel supporting documents to prevent resubmission for payment. 	<ul style="list-style-type: none"> • Observe operation of control to prevent reuse of supporting purchase documents.
Control Objective: Remit disbursements to vendors and others, such as for dividends, debt service, and tax or other payments, in a timely and accurate manner.		
Risk to Achieving Objective		
<ul style="list-style-type: none"> • Inaccurate, untimely, or unavailable information regarding amounts or due dates of payments 	<ul style="list-style-type: none"> • Compare payment amounts and recipients with source documents; verify accuracy of supporting documents. 	<ul style="list-style-type: none"> • Obtain a file of cash disbursements recorded during the period. Select a sample of disbursements and examine supporting documentation to determine that key information is in agreement.
Control Objective: Record cash disbursements completely and accurately.		
Risk to Achieving Objective		
<ul style="list-style-type: none"> • Missing documents or information 	<ul style="list-style-type: none"> • Match disbursement records against accounts payable/open invoice files. • Prenumber and account for checks. • Reconcile bank statements to cash accounts and investigate long-outstanding checks by individuals independent of accounts payable and cash disbursement functions. 	<ul style="list-style-type: none"> • Obtain a file of checks used during the period and identify and account for all gaps in sequencing. • Obtain the company's bank reconciliations for all open bank accounts. For a sample of reconciliations, reperform the procedures or otherwise determine that the reconciliation was performed properly.

Objective and Risk	Example Controls	Example Tests of Operating Effectiveness
Control Objective: Safeguard cash and the related accounting records.		
Risk to Achieving Objective		
<ul style="list-style-type: none"> • Inadequate physical security over cash and documents that can be used to transfer cash 	<ul style="list-style-type: none"> • Segregate custodial and record-keeping functions. • Reconcile bank accounts by individuals without responsibility for cash receipts, disbursements, or custody. • Receive and prelist cash by individuals independent of recording cash receipts. • Restrictively endorse checks on receipt. • Deposit receipts intact daily. • Restrict access to accounts receivable files and files used in processing cash receipts. • Mail checks by individuals independent of recording accounts payable. • Authorized check signers are independent of cash receipts functions. • Physically protect mechanical check signers and signature plates. • Restrict access to accounts payable files and files used in processing cash disbursements. 	<ul style="list-style-type: none"> • Obtain the company's bank reconciliations for all open bank accounts. For a sample of reconciliations, reperform the procedures or otherwise determine that the reconciliation was performed properly. • Make inquiries relating to and observe the operation of the company's controls over the endorsement of checks on receipt. • Test logical access to accounts receivable files and other files used in processing cash receipts and disbursements as part of the tests of IT general controls. • Make inquiries of and observe the controls that restrict physical access to mechanical check signers and signature plates.

Example Testing Program for Control Operating Effectiveness: Payroll

PURPOSE

This form provides an example testing program that links the tests of operating effectiveness of activity-level controls to related controls, control objectives, and risks to achieving those objectives. Use this form to help you design tests of activity-level controls at your organization.

INSTRUCTIONS

To modify these example testing programs to fit the particular circumstances of your company, you should first identify the control objectives that are comparable to the control objectives at your company. Identify the control procedures in place to satisfy those objectives and which of those control procedures are most important in the prevention or detection of material misstatements. Using the example tests as a guide, design your own tests of operating effectiveness that are appropriate for the controls in place at the company.

You also should identify control objectives relevant to your company that are not included in the example testing program. Identify the control procedures related to these objectives, determine which of these procedures should be tested, and design the appropriate test.

Objective and Risk	Example Controls	Example Tests of Operating Effectiveness
Control Objective: Calculate and record payroll accurately and completely for all services actually performed and approved, and only for such services.		
Risk to Achieving Objective		
<ul style="list-style-type: none"> • Pay rates or deductions are not properly authorized or are inaccurate. 	<ul style="list-style-type: none"> • Review and approve initial pay and any subsequent additions or changes. • Periodically verify payroll database information. • Review and approve initial deductions/benefit elections. • Use standard forms for making changes to payroll information. • Review and approve all nonstandard items such as sick, vacation, and bonus pay. • Review payroll register and checks for reasonableness. • Establish security controls that limit access to payroll database. 	<ul style="list-style-type: none"> • Obtain payroll database. Select a sample of data and compare it to supporting information. Data selected for testing should include employee name and <ul style="list-style-type: none"> - Pay rate - Deductions and benefit elections Make inquiries and observe operation of payroll data input controls. • Obtain a file of nonstandard payroll items such as sick, vacation, or bonus pay. Select a sample of items and ensure key information agrees with relevant supporting documents. • Test logical access controls over payroll database as part of IT general controls review.
<ul style="list-style-type: none"> • Hours are not authorized or are inaccurate. 	<ul style="list-style-type: none"> • Review and approve time records for unusual or nonstandard hours and for overtime. 	<ul style="list-style-type: none"> • Obtain a file of overtime pay or other pay related to unusual or nonstandard hours. Select a sample of transactions and compare key data to supporting documentation and determine that circumstances requiring the overtime or other hours were authorized properly.

<ul style="list-style-type: none"> • Time cards or other source information is submitted for nonexistent employees. 	<ul style="list-style-type: none"> • Use standardized policies and procedures when hiring employees. • Establish security procedures relating to additions and deletions of employees to or from the database. • Maintain logs or other documentation supporting or tracking changes to the payroll database. • Where practical, require valid identification and employee signature to receive paycheck. • Prohibit payment of wages in cash, except in prescribed circumstances. • Use direct-deposit systems. 	<ul style="list-style-type: none"> • Make inquiries and observe the operation of controls related to the addition or deletion of employees to or from the payroll database. • Test logical access controls over the payroll database as part of IT general controls review. • Obtain a file of changes made to the payroll database during the period. Select a sample of transactions and examine supporting documentation to determine that the change was authorized properly.
<ul style="list-style-type: none"> • Lack or loss of information or documents 	<ul style="list-style-type: none"> • Verify that source documents such as time cards are received for all employees. • Maintain backup records of employees' time in case source documents are lost. • Reconcile the employee subsidiary ledger to the general ledger control accounts; investigate any differences. • Compare total hours and number of employees input with the totals in the payroll register. 	<ul style="list-style-type: none"> • Obtain reconciliations of payroll subsidiary ledger to general ledger payroll accounts. Select a sample of reconciliations and determine that the reconciliations were performed properly.

Objective and Risk	Example Controls	Example Tests of Operating Effectiveness
Control Objective: Restrict access to payroll data information to only those individuals who need such information to discharge duties.		
Risk to Achieving Objective		
<ul style="list-style-type: none">Unauthorized personnel may gain access to payroll information.	<ul style="list-style-type: none">Access to information stored on electronic media is restricted by frequently changed passwords.Payroll processing systems and written information are subject to physical security.	<ul style="list-style-type: none">Test logical access controls over payroll database as part of IT general controls review.Make inquiries and observe the performance of controls that restrict the physical access to payroll processing systems and documents.

Work Program for the Review of a Type 2 SAS No. 70 Report

PURPOSE

This form has been designed to

- Facilitate the effective review of a Type 2 SAS No. 70 report on service organization controls
- Help ensure that the company's assessment of internal control at a service organization is complete and thorough

INSTRUCTIONS

Use this form to guide the review of a Type 2 SAS No. 70 report received from the company's service organization. As each step in the program is completed, the person responsible for performing the step should write his or her initials and the date in the indicated column on the worksheet. If the step is not applicable, indicate that by noting "N/A."

Issues related to the planning of the receipt of such reports (e.g., identifying the business processes, accounts, and relevant assertions affected by service organization processing) are covered in ADM-1, General Work Program.

Notations in italics are additional instructions to the preparer of the form and should be removed before the form is considered final.

WORK PROGRAM FOR THE REVIEW OF A TYPE 2 SAS NO. 70 REPORT

Company: _____

Reporting Date: _____

Prepared by: _____

Date Prepared: _____

This form summarizes the procedures we performed to review and assess the effectiveness of internal controls maintained by a service organization, as described in a service auditor's Type 2 SAS No. 70 Report.

Procedure Performed	N/A Performed by	Date
Read and Assess the Implications of the Type 2 SAS No. 70 Report		
<ol style="list-style-type: none"> 1. Read the service auditor's report and assess its implications for the company's assessment of internal control effectiveness. Consider <ol style="list-style-type: none"> a. Whether the service auditor prepared a Type 2 report b. The nature of the opinions rendered and whether these included any modifications to the standard reporting language c. The timing of the SAS No. 70 engagement, that is, <ol style="list-style-type: none"> i. The date as of which the description of controls applies ii. The period of time covered by the tests of operating effectiveness of controls 2. Read the description of the service organization's controls and evaluate the effect of the following on the company's assessment of internal control effectiveness. <ol style="list-style-type: none"> a. Whether the description includes all significant transactions, processes, computer applications, or business units that are within the scope of the company's assessment of internal control effectiveness b. Whether the description includes all five components of internal control c. Whether the description is sufficiently detailed to understand how the service organization's processing affects the company's internal control over financial reporting d. Changes to service organization controls e. Instances of noncompliance with service organization controls f. Whether the description of controls is adequate to provide an understanding of those elements of the company's accounting information system maintained by the service organization 		

Procedure Performed	N/A Performed by	Date
<p>3. List all complementary user organization controls identified in the SAS No. 70 report that the service auditor assumed were maintained by the company (“user controls”). Cross-reference this list to the work performed to</p> <ul style="list-style-type: none">a. Assess the design effectiveness of these user controlsb. Test the operating effectiveness of these user controls <p>Tests of Operating Effectiveness</p> <p>4. Review the service auditor’s description of the tests of controls and assess their adequacy for your purposes. Consider</p> <ul style="list-style-type: none">a. The link between the financial statement assertion and the control objectiveb. The link between the control objective and the controls testedc. The nature, timing, and extent of the tests performed <p>5. Evaluate the results of the tests of controls.</p> <ul style="list-style-type: none">a. Identify control testing exceptions and determine whether they indicate a control deficiency.b. Summarize all control deficiencies and assess their significance, both individually and in combination.		

Type 2 SAS No. 70 Report Review Checklist

PURPOSE

This form has been designed to

- Document the procedures performed and conclusions reached on the effectiveness of internal controls maintained at a service organization, as documented in a service auditor's Type 2 SAS No. 70 report.

INSTRUCTIONS

Use this form to document the review of a Type 2 SAS No. 70 report.

Notations in italics are additional instructions to the preparer of the form and should be removed before the form is considered final.

TYPE 2 SAS NO. 70 REPORT REVIEW CHECKLIST

Company: _____ Reporting Date: _____

Prepared by: _____ Date Prepared: _____

This form summarizes the procedures we performed and conclusions reached on the effectiveness of internal controls maintained at service organization, as documented in a service auditor's Type 2 SAS No. 70 report.

PART I: GENERAL INFORMATION

Name of Service Organization _____

As of date for description of service organization controls _____

Period covered by service auditor's tests of control operating effectiveness _____

Types of transactions processed by the service organization that affect the company’s financial statements

The significant financial statement accounts and disclosures and relevant assertions affected by transactions processed by the service organization

PART II: REVIEW OF SERVICE AUDITOR’S REPORT

The following summarizes the opinions provided in the service auditor’s report.

Required Opinion	Service Auditor Opinion	
	Standard	Modified
Whether the service organization’s description of its controls presents fairly, in all material respects, the relevant aspects of the service organization’s controls that had been placed in operation as of a specific date	<input type="checkbox"/>	<input type="checkbox"/>
Whether the controls were suitably designed to achieve specified control objectives	<input type="checkbox"/>	<input type="checkbox"/>
Whether the controls that were tested were operating with sufficient effectiveness to provide reasonable, but not absolute, assurance that the control objectives were achieved during the period specified	<input type="checkbox"/>	<input type="checkbox"/>

Describe any modifications to the service auditor's standard opinion and the effect these modifications have on the company's assessment of internal control effectiveness.

PART III: REVIEW OF THE SERVICE ORGANIZATION'S DESCRIPTION OF CONTROLS

	Internal Control Component							
	Control Environment		Risk Assessment		Information and Communication		Monitoring	
	Yes	No	Yes	No	Yes	No	Yes	No
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1. All transactions, processes, computer applications, or business units that affect the company's assessment of internal control effectiveness are described in the SAS 70 report.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. The level of detail provided is sufficient to allow us to understand how the service organization's processing affects the company's internal control.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. The SAS 70 report identified <i>no</i> changes to controls since the later of the date of the last service auditor's report or within the last 12 months.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. The SAS 70 report identified <i>no</i> instances of noncompliance with the service organization's controls identified in the service organization's description of controls.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Additional Questions for the Information Component of Internal Control

These questions apply only to those elements of the information system that are maintained by the service organization. To the extent that the company is responsible for performing certain accounting information functions (e.g., the preparation of significant estimates or disclosures), you should mark the question “N/A.”

	Yes	No	N/A
5. The service auditor's report is adequate to allow us to obtain sufficient knowledge of the information relevant to the company's financial reporting to understand those elements of the information system maintained by the service organization related to			
a. The classes of transactions in the company's operations that are significant to the financial statements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. The procedures, both automated and manual, by which transactions are initiated, recorded, processed, and reported from their occurrence to their inclusion in the financial statements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. The related accounting records, whether electronic or manual; supporting information; and specific accounts in the financial statements involved in initiating, recording, processing, and reporting transactions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. How the information system captures other events and conditions that are significant to the financial statements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Tests of Controls

Identify the relevant financial statement assertions affected by service organization services. Summarize these assertions across the horizontal axis. For each assertion, answer the questions listed in the first column, and document your answers by checking the appropriate box.

	Assertions for Which Control Risk to Be Assessed below Maximum									
	A		B		C		D		E	
	Y	N	Y	N	Y	N	Y	N	Y	N
1. Is the assertion linked to a service organization control objective?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Is the control objective linked to related control activities?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Is the description of the nature, timing, and extent of the tests applied in sufficient detail to enable you to determine the effect of the tests on your assessment of internal control effectiveness?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Do the results of the service auditor’s tests support an assessment that internal control is effective?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Response

The following describes how any “No” responses to the preceding questions were considered in our internal control assessment.

Describe any “No” responses to the preceding questions by documenting

- *The conditions cited in the SAS 70 report that gave rise to the “no” response*
- *How the conditions were considered in the overall assessment of internal control effectiveness*

PART III: COMPLEMENTARY USER ORGANIZATION CONTROLS

The following describes significant user organization controls and the procedures we performed to test their effectiveness.

List the controls identified in the SAS 70 report that the service organization assumed were placed in operation at the user organization (“user controls”). Describe (or indicate where the relevant information can be found regarding) the procedures performed, information gathered, and conclusions reached regarding the design and operating effectiveness of these user controls.

Process Owners' Monitoring of Control Effectiveness

PURPOSE

This form has been designed to

- Obtain the business process owner's perspective on the most significant transactions and related controls in his or her area of operations
- Gather information about the monitoring component of internal control at the activity level
- Identify possible control deficiencies related to activity-level controls

INSTRUCTIONS

The questionnaire on the following pages is designed to gather information from business process owners about the procedures they perform to monitor the ongoing effectiveness of control activities in their process area. The questionnaire should be completed by the process owner and should serve as a basis for follow-up questions.

Monitoring

Monitoring is a process that assesses the quality of internal control performance over time. It involves assessing the design and operation of controls on a timely basis and taking necessary corrective actions. Monitoring may be done at both the entity and the activity level. Examples of ongoing monitoring activities at the activity level include

- The regular management and supervisory activities carried out in the normal course of business
- The provision that employees may be required to "sign off" to evidence the performance of critical control functions, which allows management to monitor the performance of these control functions

REPORTING CONTROL DEFICIENCIES

Providing information regarding internal control deficiencies to the right people is critical if the internal control system is to continue to function effectively. For this reason, the

monitoring component of internal controls should include a mechanism for reporting internal control deficiencies and taking appropriate action. COSO uses the term “deficiency” broadly to mean any condition of an internal control system “worthy of attention.” Certainly all deficiencies that can affect the entity’s ability to produce reliable financial information should be identified and reported. However, the COSO report also makes the point that even seemingly simple problems with a relatively simple, obvious solution should be carefully considered because they might have far-reaching implications. Reinforcing a concept introduced in its discussion of information and communication, when errors and deficiencies are identified, their underlying causes should be investigated.

Findings of internal control deficiencies should be reported to the individuals who are in the best position to take action. This includes not only the person responsible for the activity involved, but also to at least one level of management above the directly responsible person.

PROCESS OWNERS MONITORING OF CONTROL EFFECTIVENESS

This questionnaire should be distributed to the business process owners from whom you want to gather information.

INTRODUCTION

One of the key components of your company’s internal control is the way in which management monitors the continued effectiveness of the control policies and procedures it has put into place. As a process owner, you play an important role in identifying conditions that indicate that controls are *not* operating effectively and in taking appropriate corrective actions. This questionnaire is designed to help us better understand how you perform this function.

BACKGROUND INFORMATION

Your Name _____

1. Briefly describe the business process for which you are responsible (e.g., sales, purchasing, inventory management).

2. Within your business process, what are the most significant business transactions for which you are responsible? Consider those transactions that either
 - Generate revenue for the company
 - Create or acquire company assets

- Incur company obligations or liabilities
- Result in company expenses
- Involve the receipt or disbursement of cash

3. For each of the transactions described in question 2, briefly summarize the control procedures that you rely on most to ensure that the information related to these transactions is properly captured and processed. In preparing your summary, please describe the controls in place to ensure that

- Transactions are properly authorized
- *All* authorized transactions are captured and processed
- *Only* authorized transactions are captured and processed
- Data are captured and processed at their proper amounts

MONITORING ONGOING CONTROL EFFECTIVENESS

4. Suppose that one or more of the control procedures described in question 3 were *not* functioning effectively.
- a. What activities do you regularly perform that would alert you to the possibility that controls in your process area were not functioning effectively?

- b. What information do you receive from parties outside the company that would alert you to the possibility that controls in your process area were not functioning effectively (e.g., customer complaints about the accuracy of their billing statements)? Consider outside parties such as

- Customers
- Vendors
- Regulators
- Others with whom the company does business

5. Describe the procedures in place to ensure that you receive feedback from both internal and external auditors about control deficiencies or suggestions for ways to improve internal control.

6. If you have responsibility for tangible assets (e.g., inventory), describe the procedures followed to compare the information recorded in the company’s books and records to the physical assets.

**IDENTIFICATION AND FOLLOW-UP
ON IDENTIFIED DEFICIENCIES**

7. Describe any indications that currently exist that may indicate that the controls described in question 3 are not functioning effectively. Consider those indications that arose from
- The performance of your regular activities
 - Information received from third parties
 - Feedback from internal or external auditors

8. With regard to the items identified in question 7, what actions did you take? (If no items were identified in question 7, please describe the actions that you would take if you became aware of control deficiencies.)

PART IV

**Example Letters and
Other Communications**

Example Engagement Letter for Outside Consultants to Management

PURPOSE

Outside consultants who have been engaged to assist management in their assessment of internal control effectiveness should reach an understanding with management regarding key elements of their engagement, including

- The services to be performed, including their
 - Objectives
 - Nature
 - Timing
 - Limitations
- Deliverables or work product
- The responsibilities of the parties
- Fees

The following is an example of a letter that can be used to confirm such an understanding between management and the outside consultant. Typically, this letter is sent from the consultant to company management.

EXAMPLE LETTER

[Consulting Firm's Letterhead]

[Date]

[Client's Name and Address]

It was a pleasure to discuss with you how [consulting firm's name] can help [client's name] in its assessment of the effectiveness of internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002, for the year ended [year-end]. We are writing to confirm our understanding of the services we are to provide, including the limitations of those services.

The objective of our services is to assist [client's name] management in [provide general description].^a

We will work with you and the selected project team from [client's name] to:

- [List nature of services to be performed]
-
-
-

Upon completion of the work described in the preceding paragraph, we will work with you and the selected project team from [client's name] to complete the following:

- [List key deliverables]
-
-
-

During the performance of our engagement we may become aware of testing exceptions or other conditions that indicate a control deficiency may exist. We will inform you of all such exceptions or conditions as they become known to us.

The management of [client's name] is responsible for

- Establishing and maintaining adequate internal control over financial reporting for the company
- Assessing the effectiveness of the company's internal control over financial reporting as of the end
- Identifying and disclosing material weaknesses in internal control^b

Throughout our engagement we may provide advice, research materials, as appropriate, and recommendations to assist [client's name] management in performing its functions and making decisions. However, we will not perform management functions or make management decisions, which are the responsibility of [client's name] management and which include but are not limited to the following.

- The general oversight of [client's name] management's assessment of the effectiveness of internal control over financial reporting
- The evaluation of whether the nature, timing, scope, and deliverables of the services performed are sufficient for your purposes
- The determination of whether identified control testing exceptions constitute a control deficiency
- The evaluation of the relative significance of identified control deficiencies, including whether such deficiencies constitute a "significant deficiency" or "material weakness," as defined in PCAOB Auditing Standard No. 2

- The formation of an assessment of the effectiveness of internal control over financial reporting

Disclaimer. Given the subjective nature of assessing the effectiveness of internal control over financial reporting, as well as the heavy reliance on active participation of [client name] personnel in achieving the objectives of this project, we cannot warrant or guarantee the objectives will be met to the satisfaction of [client name] external auditors.

The senior members of the project team from [consulting firm] will consist of [list senior members of project team]. Other resources will be added to the project team as needed to meet the needs of [client's name] management. As team members are added, we will notify [client's name] management of each team member and their role on the project team.

[Client name] management will provide the majority of the resources for the project team. The timeline and fee estimates in this agreement assume the focused attention of this team on the project. We also assume that [client individual] will be the senior member of [client's name] management's project team and in that capacity will have primary oversight responsibilities for the team. We will communicate directly with [him or her] in regard to project issues as needed.

We expect to begin our engagement on approximately [date].^c

We estimate our fees for these services will range from \$_____ to \$_____, plus a reimbursement of reasonable and ordinary expenses including, but not limited to, travel, meals, supplies, and communication costs. If unexpected circumstances arise that may result in the incurrence of significant additional time, we will inform you immediately and, if necessary, discuss any adjustments to our fees. These fees will be billed as the work progresses and are payable [describe payment terms].

If the above terms and conditions meet with your approval, please sign and return the enclosed copy of this letter. We are enthusiastic about the opportunity to provide services to [client name]. Of course, should you have any questions or comments, please do not hesitate to call me.^d

^a The objective of the consultant's services is to assist management in the fulfillment of its responsibilities. In this paragraph you should provide a general description of the phase of management's assessment of internal control that you will be helping them with. For example, ". . . to assist management in the documentation of entity-level controls," or "to assist management in testing the operating effectiveness of certain activity-level controls."

^b This list of responsibilities was adapted from the SEC rules. See Items 308(a) and (c) of Regulation S-B and S-K, 17 C.F.R. 228.308 (a) and (c) and 229.309 (a) and (c), respectively.

^c You may wish to attach a timeline of the expected start and completion dates of significant phases of the engagement.

^d You may wish to include other clauses in your engagement letter, such as those relating to

- Ownership of work product
- Alternative dispute resolution
- Compensation for firm employees hired by client or client employees hired by firm
- Circumstances under which agreement may be terminated

Very truly yours,

ACCEPTANCE:

This letter correctly sets forth the understanding of the engagement.

Signature: _____

Title: _____

Date: _____

Example Management Representation Letter

PURPOSE

Paragraph 142 of PCAOB Auditing Standard No. 2 requires the external auditor to obtain certain written representations from management in connection with their audit of the company's internal control over financial reporting. The following is an example of a letter that can be used for this purpose.

EXAMPLE LETTER

[Company Letterhead]

[Date]¹

To [Independent Auditor]

We are providing this letter in connection with your audit of internal control over financial reporting of [name of entity] as of [date]. This audit was performed for the purpose of expressing an opinion on management's assessment of the effectiveness of the company's internal control over financial reporting. We confirm that we are responsible for establishing and maintaining effective internal control over financial reporting.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, as of [date of auditor's report], the following representations made to you during your audit.

1. We have performed an assessment of the effectiveness of the company's internal control over financial reporting using the criteria set forth by [identify criteria].²
2. We did not use the procedures performed during your audits of internal control over financial reporting or the financial statements as part of the basis for our assessment of the effectiveness of internal control over financial reporting.

3. Based on our assessment, we believe that, as of [year-end], the company's internal control over financial reporting [is/is not] effective based on the criteria identified in 1 above.
4. We have disclosed to you all deficiencies in the design or operation of internal control over financial reporting identified as part of our assessment, including separately disclosing all such deficiencies that we believe to be significant deficiencies or material weaknesses in internal control over financial reporting.
5. We have no knowledge of any material fraud involving our employees.
6. We have no knowledge of any fraud that involves³
 - a. Senior management or
 - b. Management or
 - c. Other employees who have a significant role in the company's internal control over financial reporting
7. All control deficiencies identified and communicated to the audit committee during previous audit engagements have been resolved, except for [list those control deficiencies that have not been resolved, if applicable].

Subsequent to [year-end], there have been no changes in internal control over financial reporting or other factors that might significantly affect internal control over financial reporting, including any corrective actions we have taken with regard to significant deficiencies and material weaknesses.

[Name of Chief Executive Officer and Title]

[Name of Chief Financial Officer and Title]

¹ The letter should be dated no earlier than the date of the auditor's report on internal control over financial reporting.

² For example, "the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control Integrated Framework."

³ If you have knowledge of any material fraud or any other fraud that, although not material, involves senior management or management or other employees who have a significant role in the company's internal control over financial reporting, these should be described in the letter.

Example Management Reports on Effectiveness of Internal Control over Financial Reporting¹

PURPOSE

Guidance on the preparation of management's reports on the effectiveness of internal control over financial reporting is provided by the following.

- Item 308(a) of Regulation S-B and S-K, 17 C.F.R. 228.308(a) and 17 C.F.R. 229.308(a)
- Questions 1, 2, 3, and 19 of Internal Control over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports: Frequently Asked Questions, published by the staff of the SEC Office of the Chief Accountant and the Division of Corporation Finance

The following are examples of such reports.

EXAMPLE 1: MANAGEMENT REPORT WHEN INTERNAL CONTROL OVER FINANCIAL REPORTING IS EFFECTIVE

The management of [company name] is responsible for establishing and maintaining adequate internal control over financial reporting. This internal control system was designed to provide reasonable assurance to the company's management and board of directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. (*Author's note: This statement regarding the inherent limitation of internal control is not required by SEC rules. It is included in this example report solely for illustrative purposes.*)

¹ These example reports originally appeared, in slightly different form, in the article "Section 404 Compliance in the Annual Report," by Michael Ramos, published by the Journal of Accountancy, October 2004, page 43. Reprinted with the permission of the Journal of Accountancy. Opinions of the author are his own and do not necessarily reflect policies of the AICPA. The author wishes to thank Chuck Landes and Laura Phillips for their input during the development of these examples.

[Company name] management assessed the effectiveness of the company's internal control over financial reporting as of [year-end]. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control—Integrated Framework*. Based on our assessment, we believe that, as of [year-end], the company's internal control over financial reporting is effective based on those criteria.

[Company name]'s independent auditors have issued an audit report on our assessment of the company's internal control over financial reporting. This report appears on page XX.

EXAMPLE 2: MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING WHEN MATERIAL WEAKNESSES HAVE BEEN IDENTIFIED

[Introductory paragraph—same as in example 1.]

[Optional, inherent limitations paragraph—see example 1.]

An internal control material weakness is a significant deficiency, or combination of them, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

The management of [company name] assessed the effectiveness of the company's internal control over financial reporting as of [year-end], and this assessment identified the following material weakness in the company's internal control over financial reporting.

[Describe the material weakness.]

[Company name] management assessed the effectiveness of the company's internal control over financial reporting as of [year-end]. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control—Integrated Framework*. Because of the material weakness described in the preceding paragraph, management believes that, as of [year-end], the company's internal control over financial reporting was not effective based on those criteria.

[Company name]'s independent auditors have issued an attestation report on management's assessment of the company's internal control over financial reporting. It appears on page XX.

Example Subcertification

PURPOSE

A great deal of the information included in financial statements and other reports filed with the SEC originates in areas of the company that are outside the direct control of the chief executive officer (CEO) and chief financial officer (CFO). Because of the significance of information processed and related controls that are the responsibility of others, the CEO and CFO may request those individuals to provide certain representations. This process is known as *subcertification*, and it usually requires the individuals to provide a written affidavit to the CEO and CFO that will allow them to sign their report on internal control effectiveness in good faith.

The following is an example of a subcertification letter.

EXAMPLE LETTER

[Company Letterhead]

[Date]¹

To [CEO and CFO]

I am providing this letter in connection with your assessment of the effectiveness of internal control over financial reporting of [name of entity] as of [date].² As the [title of individual signing the letter], I am responsible for establishing and maintaining effective internal control over financial reporting for [name of business unit, location, division, etc.].³

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

I confirm, to the best of my knowledge and belief, as of [date of management's representation letter to the external auditors], the following representations made to you.

1. I have performed an assessment of the effectiveness of [name of business unit, location, division, etc.] internal control over financial reporting using the criteria set forth by [identify criteria].⁴
2. I did not use the procedures performed during the external auditor's audits of internal control over financial reporting or the financial statements as part of the basis

for my assessment of the effectiveness of internal control over financial reporting for [name of business unit, location, division, etc.].

3. Based on my assessment, I believe that, as of [year-end], the [name of business unit, location, division, etc.] internal control over financial reporting [is/is not] effective based on the criteria identified in 1 above.
4. I have disclosed to you all deficiencies in the design or operation of internal control over financial reporting identified as part of my assessment, including separately disclosing all such deficiencies that I believe to be significant deficiencies or material weaknesses in internal control over financial reporting.
5. I have no knowledge of any material fraud involving the employees of [name of business unit, location, division, etc.].
6. I have no knowledge of any fraud that involves⁵
 - a. Senior management of [name of business unit, location, division, etc.] or
 - b. Management of [name of business unit, location, division, etc.] or
 - c. Other employees of [name of business unit, location, division, etc.] who have a significant role in internal control over financial reporting
7. All control deficiencies relating to [name of business unit, location, division, etc.] that were identified and communicated to the audit committee during previous audit engagements have been resolved, except for [list those control deficiencies that have not been resolved, if applicable].

Subsequent to [year-end], there have been no changes in internal control over financial reporting or other factors that might significantly affect internal control over financial reporting, including any corrective actions we have taken with regard to significant deficiencies and material weaknesses.

[Name]

[Title]

¹ The letter should be dated the same as the CEO's and CFO's representation letter to the external auditors.

² This example letter is limited to representations required as a result of the external auditor's audit of internal control. Additional letters may be required for representations relating to the audit of the financial statements. Alternatively, the representations related to internal control and those related to the audit of the financial statements may be combined into one comprehensive letter.

³ The signer of the letter should clearly indicate the scope of the representations being made, for example, that they are limited to the business unit or location for which the signer has direct responsibility.

⁴ For example, "the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control Integrated Framework."

⁵ If you have knowledge of any material fraud or any other fraud that, although not material, involves senior management or management or other employees who have a significant role in the company's internal control over financial reporting, these should be described in the letter.

PART V

**Tools for External
Auditors Performing an
Audit of Internal Control**

General Audit Program

PURPOSE

This form has been designed to

- Facilitate the effective organization of an efficient process for performing an audit of internal control over financial reporting

INSTRUCTIONS

Use this form to guide the design and performance of the audit of internal control. As the steps in program are completed, the person responsible for performing the step should initial and date in the indicated column on the worksheet. If the step is not applicable, indicate that by noting "N/A." Use the "Notes" column to cross-reference to where the performance of the procedure is documented, or to make other notations.

Notations in italics are additional instructions to the preparer of the form and should be removed before the form is considered final.

AUDIT OF INTERNAL CONTROL OVER FINANCIAL REPORTING GENERAL AUDIT PROGRAM

Company: _____

Reporting Date: _____

Prepared by: _____

Date Prepared: _____

Procedure Performed	N/A Performed by	Date	Notes
Pre-engagement Planning			
1. Form the audit team. Consider both the resources and the expertise needed to successfully complete the audit, including IT expertise.			
2. Determine the nature of the internal control services, if any, that the firm will provide or has provided to the company during the current audit period. a. If the firm will provide internal control services to the company, obtain preapproval of the board.			
3. Assess whether management will be able to fulfill the following responsibilities. a. Accept responsibility for the effectiveness of the company's internal control over financial reporting. b. Evaluate the effectiveness of internal control over financial reporting using suitable criteria. c. Support its evaluation with sufficient evidence, including documentation. d. Present a written assessment of the effectiveness of the company's internal control over financial reporting as of the end of the company's fiscal year.			
Audit Planning			
4. Obtain information and evaluate how the following matters will affect your audit procedures. a. Knowledge of the company's internal control over financial reporting obtained during other engagements			

Procedure Performed	N/A Performed by	Date	Notes
<p>b. Matters affecting the industry in which the company operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes</p> <p>c. Matters relating to the company's business, including its organization, operating characteristics, capital structure, and distribution methods</p> <p>d. The extent of recent changes, if any, in the company, its operations, or its internal control over financial reporting</p> <p>e. Management's process for assessing the effectiveness of the company's internal control over financial reporting based upon control criteria</p> <p>f. Preliminary judgments about materiality, risk, and other factors relating to the determination of material weaknesses</p> <p>g. Control deficiencies previously communicated to the audit committee or management</p> <p>h. Legal or regulatory matters of which the company is aware</p> <p>i. The type and extent of available evidence related to the effectiveness of the company's internal control over financial reporting</p> <p>j. Preliminary judgments about the effectiveness of internal control over financial reporting</p> <p>k. The number of significant business locations or units, including management's documentation and monitoring of controls over such locations or business units</p>			

Procedure Performed	N/A Performed by	Date	Notes
<p>5. Gather current information on internal control and make this available to the audit team members to allow them to better plan the audit. Consider information sources such as</p> <ul style="list-style-type: none"> • The effect of findings of all substantive procedures performed in the audit of year-end or interim financial statements • Recent SEC filings, including the most recent 10-K, 10-KSB, and all 10-Qs subsequently filed • Documentation of tests performed in previous audits of internal control • Previously identified testing exceptions or control deficiencies that were communicated to management, either from the firm or from sources internal to the company • The company's current efforts, if any, to remediate previously identified control deficiencies • Internal control reports of the company's internal auditors • The firm's communications to management on internal control matters • Guidance on internal control auditing and reporting issued by the PCAOB or SEC that has been issued since the previous audit of internal control • Relevant findings or recommendations of the company's disclosure committee 			

Procedure Performed	N/A Performed by	Date	Notes
6. Make a preliminary determination of materiality that includes both quantitative and qualitative considerations. This preliminary determination will be used to plan the audit and design procedures, and evaluate control deficiencies.			
7. Determine the extent to which the engagement team will rely on the work of management or others in the audit of internal control. For each company project team, the auditor should perform an a. Assessment of their competency b. Assessment of their objectivity			
Evaluating Management's Assessment Process and Documentation			
8. Obtain an understanding and evaluate management's process for assessing the effectiveness of the company's internal control over financial reporting by determining whether management has addressed each of the following. a. Determining which controls should be tested, including controls over all relevant assertions related to all significant accounts and disclosures in the financial statements. Generally, such controls include <ul style="list-style-type: none">Controls over initiating, authorizing, recording, processing, and reporting significant accounts and disclosures and related assertions embodied in the financial statements			

Procedure Performed	N/A Performed by	Date	Notes
<ul style="list-style-type: none"> • Controls over the selection and application of accounting policies that are in conformity with generally accepted accounting principles • Antifraud programs and controls • Controls, including information technology general controls, on which other controls are dependent • Controls over significant nonroutine and nonsystematic transactions, such as accounts involving judgments and estimates • Company-level controls (as described in paragraph 53 of PCAOB Auditing Standard No. 2), including <ul style="list-style-type: none"> • The control environment and • Controls over the period-end financial reporting process (both year-end and interim), including controls over procedures used to enter transaction totals into the general ledger; to initiate, authorize, record, and process journal entries in the general ledger; and to record recurring and nonrecurring adjustments to the financial statements (e.g., consolidating adjustments, report combinations, and reclassifications) <p>b. Evaluating the likelihood that failure of the control could result in a misstatement, the magnitude of such a misstatement, and the degree to which other controls, if effective, achieve the same control objectives.</p>			

Procedure Performed	N/A Performed by	Date	Notes
<p>c. Determining the locations or business units to include in the evaluation for a company with multiple locations or business units.</p> <p>d. Evaluating the design effectiveness of controls.</p> <p>e. Evaluating the operating effectiveness of controls based on procedures sufficient to assess their operating effectiveness.</p> <p>f. Determining the deficiencies in internal control over financial reporting that are of such a magnitude and likelihood of occurrence that they constitute significant deficiencies or material weaknesses.</p> <p>g. Communicating findings to the auditor and to others, if applicable.</p> <p>h. Evaluating whether findings are reasonable and support management’s assessment.</p>			
<p>9. Obtain an understanding of the results of procedures performed by management and others and consider how these results affect your planned procedures.</p>			
<p>10. Determine that management’s documentation provides reasonable support for its assessment by evaluating whether the documentation includes the following.</p> <p>a. The design of controls over all relevant assertions related to all significant accounts and disclosures in the financial statements.</p> <p>b. Information about how significant transactions are initiated, authorized, recorded, processed, and reported.</p>			

Procedure Performed	N/A Performed by	Date	Notes
<ul style="list-style-type: none"> c. Sufficient information about the flow of transactions to identify the points at which material misstatements due to error or fraud could occur. d. Controls designed to prevent or detect fraud, including who performs the controls and the related segregation of duties. e. Controls over the period-end financial reporting process. f. Controls over safeguarding of assets. g. The results of management's testing and evaluation. 			
<ul style="list-style-type: none"> 11. If management's documentation is inadequate, consider whether <ul style="list-style-type: none"> a. This control deficiency is only a deficiency or represents a significant deficiency or material weakness b. The inadequate documentation is a limitation on the scope of the audit of internal control 			
Obtain an Understanding of Internal Control			
<ul style="list-style-type: none"> 12. Obtain an understanding of the design of controls related to each component of internal control over financial reporting. <ul style="list-style-type: none"> a. <i>Company-level controls</i> <ul style="list-style-type: none"> • Identify and obtain an understanding of the design of entity-level controls required to be documented, evaluated, and tested according to PCAOB, SEC, or other authoritative standards. • Identify and obtain an understanding of other entity-level controls designed to meet significant control objectives. 			

Procedure Performed	N/A Performed by	Date	Notes
<p>b. <i>Centralized processing and controls</i></p> <ul style="list-style-type: none">• Identify and obtain an understanding of the design of all centralized processes and controls, including shared service environments, that affect the relevant assertions of significant accounts and disclosures. <p>c. <i>Audit committee oversight</i></p> <ul style="list-style-type: none">• Evaluate the effectiveness of the audit committee’s oversight of the company’s external financial reporting and internal control over financial reporting. <p>d. <i>Activity-level controls</i></p> <ul style="list-style-type: none">• Identify the significant accounts and disclosures within the financial statements.• For all significant accounts identified in step 11b, identify the relevant assertions.• For all significant accounts identified in step 11d, identify the major transactions affecting these accounts. Separately identify<ul style="list-style-type: none">- Routine transactions- Nonroutine transactions- Estimates• <i>Routine transactions.</i> For each routine transaction, identify the significant processing procedures.• <i>Nonroutine transactions and estimates.</i> Determine that nonroutine transactions identified are included in the consideration of company-level controls in step 11a.			

Procedure Performed	N/A Performed by	Date	Notes
<ul style="list-style-type: none"> • Identify the significant processes affecting the major transactions and for each significant process <ul style="list-style-type: none"> - Understand the flow of transactions - Identify the points within the process at which a financial statement misstatement could arise - Identify the controls that management has implemented to address these potential misstatements - Identify the controls that management has implemented over the prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets. <p><i>e. Period-end financial reporting process</i></p> <ul style="list-style-type: none"> • Obtain an understanding of the company's period-end financial reporting process and evaluate <ul style="list-style-type: none"> - The inputs, procedures performed, and outputs of the processes the company uses to produce its annual and quarterly financial statements - The extent of information technology involvement in each period-end financial reporting process element - Who participates from management - The number of locations involved 			

Procedure Performed	N/A Performed by	Date	Notes
<ul style="list-style-type: none"> - Types of adjusting entries (e.g., standard, nonstandard, eliminating, and consolidating) - The nature and extent of the oversight of the process by appropriate parties, including - management, the board of directors, and the audit committee 			
13. Determine the locations or business units to be included in the scope of the project.			
14. Identify the significant processing procedures that are performed by third-party organizations. <ul style="list-style-type: none"> a. Determine which of the services performed by a third party are part of the company's information system. b. Determine how the project team will obtain the information necessary to understand and evaluate the design and operating effectiveness of controls at the third party (e.g., by obtaining a Type 2 SAS No. 70 report). 			
15. Consider how unusual circumstances will affect the scope of the project, including <ul style="list-style-type: none"> • Business acquisitions made since the last internal control evaluation • Variable-interest entities included in the company's consolidated financial statements • Installation of a new accounting system 			
Confirm Understanding of Internal Control			
16. Perform at least one walkthrough for each major class of transaction.			

Procedure Performed	N/A Performed by	Date	Notes
Design Tests of Operating Effectiveness			
<i>[The following steps should be performed for all entity-level, common, and activity-level controls. Generally, entity-level and common control tests are performed before performing tests of activity-level controls.]</i>			
17. Describe the parameters of the test, including a. The test objective b. Definition of deviations			
18. For each control identified in step 11, select the control procedures to be tested.			
19. Determine the nature of the tests to be performed, for example <ul style="list-style-type: none"> • Inquiries or written surveys of company personnel • Inspection of documentation of control performance • Observations of control performance • Reperformance of controls 			
20. Determine the point in time at which the controls will be tested.			
21. Determine the period of time to be covered by the tests.			
22. Determine the extent of the tests to be performed. For example <ul style="list-style-type: none"> • If inquiries or surveys are to be made of company personnel, how many and which individuals will be chosen to participate? • If the control procedure is to be observed or reperformed, how many times? • If documentation is to be inspected, which ones? 			

Procedure Performed	N/A Performed by	Date	Notes
23. If the company receives a Type 2 SAS 70 report from one or more third-party organizations that are part of the company's information system, review these report(s) and evaluate their findings.			
24. If sampling techniques are to be used to select items to be tested, develop a sampling plan that addresses <ul style="list-style-type: none"> a. The population from which the sample will be drawn b. The sample size c. Sample selection methodology 			
25. Schedule the timing of the tests, for example <ul style="list-style-type: none"> • Determine which controls will be tested first and the sequencing of the tests to follow. 			
<i>[Note. Generally, entity-level and common controls are tested prior to testing activity-level controls.]</i>			
<ul style="list-style-type: none"> • Make any necessary arrangements to coordinate with company personnel or project team members included in the testing. 			
Perform and Document Tests			
26. Perform the tests designed in steps 16–24.			
27. Identify testing exceptions and determine whether they indicate the existence of one or more control deficiencies.			

Procedure Performed	N/A Performed by	Date	Notes
a. If a determination is reached that a testing exception did <i>not</i> indicate a control deficiency <ol style="list-style-type: none"> Perform and document additional procedures and Document the reasons for concluding that the testing exception was <i>not</i> considered to be a sign of a control deficiency 			
28. Communicate the results of the tests of operating effectiveness of internal control to the audit team performing the audit of the company's financial statements.			
<i>Year-End Testing</i>			
29. Assess the need to update tests of controls performed in advance of year-end. If necessary, update tests.			
30. For controls implemented since the testing date, including newly designed controls to remediate control deficiencies <ol style="list-style-type: none"> Review the documentation of the control and assess its adequacy Test the operating effectiveness of the control as of year-end 			
Form Opinions and Prepare Audit Report			
31. Form an opinion on the effectiveness of the company's internal control over financial reporting by considering the following. <ul style="list-style-type: none"> The adequacy of the assessment performed by management The results of the auditor's evaluation of the design and tests of operating effectiveness of controls 			

Procedure Performed	N/A Performed by	Date	Notes
<ul style="list-style-type: none">• The negative results of substantive procedures performed during the financial statement audit• Any identified control deficiencies			
32. Obtain written representations from management on certain matters affecting the audit of internal control.			
33. Evaluate management's report on the effectiveness of internal control, including <ol style="list-style-type: none">a. Whether management has properly stated its responsibility for establishing and maintaining adequate internal control over financial reportingb. Whether the framework used by management to conduct the evaluation is suitablec. Whether management's assessment of the effectiveness of internal control over financial reporting, as of the end of the company's most recent fiscal year, is free of material misstatementd. Whether management has expressed its assessment in an acceptable form<ul style="list-style-type: none">• Management is required to state whether the company's internal control over financial reporting is effective.• A negative assurance statement indicating that "nothing has come to management's attention to suggest that the company's internal control over financial reporting is not effective" is not acceptable.			

Procedure Performed	N/A Performed by	Date	Notes
<ul style="list-style-type: none"> • Management is not permitted to conclude that the company's internal control over financial reporting is effective if there are one or more material weaknesses in the company's internal control over financial reporting. <p>e. Whether material weaknesses identified in the company's internal control over financial reporting, if any, have been properly disclosed, including material weaknesses corrected during the period</p>			
<p>34. Prepare the auditor's report on management's assessment of internal control over financial reporting. In preparing the report, consider</p> <ul style="list-style-type: none"> • The required elements of such a report • Whether the report on internal control will be combined with the opinion on the financial statements • The report date • Whether management's assessment of control effectiveness is adequate and their report is appropriate • The existence of a material weakness at the report date • Whether there was a restriction on the scope of the audit • Whether the report of other auditors was used as a basis for the auditor's own report • Whether a significant subsequent event occurred since the date being reported on • Whether management's report includes other information that is not required 			

Procedure Performed	N/A Performed by	Date	Notes
35. Communicate in writing to management and the audit committee all significant deficiencies and material weaknesses identified during the audit.			
36. Communicate to management in writing all deficiencies in internal control over financial reporting that are of a lesser magnitude than significant deficiency. a. Inform the audit committee when such a communication should be made.			

About the CD-ROM

INTRODUCTION

This appendix provides you with information on the contents of the CD that accompanies this book. For the latest and greatest information, please refer to the ReadMe file located at the root of the CD.

SYSTEM REQUIREMENTS

- A computer with a processor running at 120 Mhz or faster
- At least 32 MB of total RAM installed on your computer; for best performance, we recommend at least 64 MB
- A CD-ROM drive

Note: Many popular word processing programs are capable of reading Microsoft Word files. However, users should be aware that a slight amount of formatting might be lost when using a program other than Microsoft Word.

USING THE CD WITH WINDOWS

To install the items from the CD to your hard drive, follow these steps:

1. Insert the CD into your computer's CD-ROM drive.
2. The CD-ROM interface will appear. The interface provides a simple point-and-click way to explore the contents of the CD.

If the opening screen of the CD-ROM does not appear automatically, follow these steps to access the CD:

1. Click the Start button on the left end of the taskbar and then choose Run from the menu that pops up.
2. In the dialog box that appears, type **d:\setup.exe**. (If your CD-ROM drive is not drive d, fill in the appropriate letter in place of d.) This brings up the CD Interface described in the preceding set of steps.

WHAT'S ON THE CD

The following sections provide a summary of the software and other materials you'll find on the CD.

Content

The CD ROM contains all of the practice aids in this book. They cover all the main phases in the internal control assessment: planning, documentation, testing and reporting. Each form and checklist from this book is included to aid in your information gathering and assessment and to help you document conclusions. You will find this material on the CD-ROM in the folder named “Content.”

Applications

The following applications are on the CD:

WORD VIEWER

Microsoft Word Viewer is a freeware viewer that allows you to view, but not edit, most Microsoft Word files. Certain features of Microsoft Word documents may not display as expected from within Word Viewer.

OPENOFFICE.ORG

OpenOffice.org is a free multi-platform office productivity suite. It is similar to Microsoft Office or Lotus SmartSuite, but OpenOffice.org is absolutely free. It includes word processing, spreadsheet, presentation, and drawing applications that enable you to create professional documents, newsletters, reports, and presentations. It supports most file formats of other office software. You should be able to edit and view any files created with other office solutions.

Shareware programs are fully functional, trial versions of copyrighted programs. If you like particular programs, register with their authors for a nominal fee and receive licenses, enhanced versions, and technical support.

Freeware programs are copyrighted games, applications, and utilities that are free for personal use. Unlike shareware, these programs do not require a fee or provide technical support.

GNU software is governed by its own license, which is included inside the folder of the GNU product. See the GNU license for more details.

Trial, demo, or evaluation versions are usually limited either by time or functionality (such as being unable to save projects). Some trial versions are very sensitive to system date changes. If you alter your computer's date, the programs will “time out” and no longer be functional.

CUSTOMER CARE

If you have trouble with the CD-ROM, please call the Wiley Product Technical Support phone number at (800) 762-2974. Outside the United States, call (317) 572-3994. You can also contact Wiley Product Technical Support at <http://www.wiley.com/techsupport>. John Wiley & Sons will provide technical support only for installation and other general quality control items. For technical support on the applications themselves, consult the program's vendor or author.

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