Section 9

Application Guidance On Internal Control, Abuse, Fraud, and Assessing the Significance of Laws, Regulations, Or Provisions Of Contracts Or Grant Agreements

The following sections provide application guidance for auditors and audited entities to assist in the implementation of generally accepted government auditing standards (GAGAS).

The following are examples of control deficiencies:

a. Ineffective oversight by those charged with governance of the entity's financial reporting, performance reporting, or internal control, or an ineffective overall governance structure.
b. An ineffective internal audit function or risk assessment function at an entity for which such functions are important to the monitoring or risk assessment component of internal control, such as for a large or complex entity.
c. Failure by management or those charged with governance to assess the effect of a deficiency previously communicated to them and either to correct it or to conclude that it does not need to be corrected.
d. Inadequate controls for the safeguarding of assets.
e. Inadequate design of information systems general, application, and user controls that prevents an information system from providing complete and accurate information consistent with financial, compliance, or performance reporting objectives or other current needs.
f. Failure of an application control caused by a deficiency in the design or operation of an information system's general controls.
g. Employees or management who lack the qualifications and training to fulfill their assigned functions.

The following are examples of abuse, depending on the facts and circumstances:

a. Creating unneeded overtime.
b. Requesting staff to perform personal errands or work tasks for a supervisor or manager.
c. Misusing the official's position for personal gain (including actions that could be perceived by an objective third party with knowledge of the relevant information as improperly benefiting an official's personal financial interests or those of an immediate or close family member; a general partner; an organization for which the official serves as an officer, director, trustee, or employee; or an organization with which the official is negotiating concerning future employment).

In some circumstances, conditions such as the following might indicate a heightened risk of fraud:

a. economic, programmatic, or entity operating conditions that threaten the entity's financial stability, viability, or budget;
b. the nature of the entity's operations provide opportunities to engage in fraud;
c. management's monitoring of compliance with laws, regulations, and policies is inadequate;
d. the organizational structure is unstable or unnecessarily complex;
e. management communication or support for ethical standards is lacking;
f. management is willing to accept unusually high levels of risk in making significant decisions;
g. the entity has a history of impropriety, such as previous issues with fraud, questionable practices, or past audits or investigations with findings of questionable or criminal activity;
h. operating policies and procedures have not been developed or are outdated;
i. key documentation is lacking or does not exist;
j. asset accountability or safeguarding procedures are lacking;
k. a history of improper payments;
l. evidence of false or misleading information; and
m. evidence of unusual patterns and trends in contracting, procurement, acquisition, and other activities of the entity or program.

Government programs are subject to many laws, regulations, and provisions of contracts or grant agreements. At the same time, their significance within the context of the audit objectives varies widely, depending on the objectives of the audit. Auditors may find the following approach helpful in assessing whether laws, regulations, or provisions of contracts or grant agreements are significant within the context of the audit objectives:

a. Auditors may consult with either their own or management's legal counsel to (1) determine those laws and regulations that are significant to the audit objectives, (2) design tests of compliance with laws and regulations, or (3) evaluate the results of those tests. Auditors also may consult with either their own or management's legal counsel when audit objectives require testing compliance with provisions of contracts or grant agreements. Depending on the circumstances of the audit, auditors may consult with others, such as investigative staff, other audit organizations or government entities that provided professional services to the audited entity, or applicable law enforcement authorities, to obtain information on compliance matters.