

**DOCUMENTATION OF THE ENTITY AND ITS ENVIRONMENT
INCLUDING INTERNAL CONTROLS**

Completed by: _____ **Date:** _____

Full legal name and address of the entity:

Telephone number: _____

Fax number: _____

Principal contact person(s) (name and title):

Email address: _____

Type of entity:

- Corporation Partnership LLC/LLP
 S-corporation Sole proprietor Nonprofit organization (§ 501 ___)
 Government: Municipality County/Parish School district
 Special district (indicate type) _____

Describe the entity's principal activities and/or services:

Describe the locations of the entity, the approximate number of employees at each location and the services or activities that are carried on at each location:

Governance

Title of those charged with governance:

Board of directors Partners Shareholders
 Members Governing board Other _____

List and describe the members of those charged with governance:

Name	Title	Principal occupation/background

For interim communication of significant findings and issues, indicate the member or members of those charged with governance with whom we should contact by placing an asterisk beside the appropriate names.

Overall assessment of the knowledge and skills of those charged with governance:

Ability to read and understand:

Financial statements:

Competent Limited No ability

Notes to financial statements:

Competent Limited No ability

Knowledge and understanding of applicable laws and regulations:

Extensive Moderate Limited

Management

List and describe the principal members of management. Also indicate whether the manager is also charged with governance:

Name	Title	Principal occupation/background

Overall assessment of the knowledge and skills of management:

Ability to read and understand:

Financial statements:

Competent Limited No ability

Notes to financial statements:

Competent Limited No ability

Knowledge of applicable laws and regulations:

Extensive Moderate Limited

Organizational structure (describe or attach organization chart):

Industry, regulatory and other external factors

What is the industry in which the entity operates?

Do the following apply to the industry?

Audit and Accounting Guide? Audit Risk Alert?

Other practice aids or materials? Describe: _____

Does the firm subscribe to and review the above publications?

Yes No

Are there specialized accounting practices that apply to the industry?

Yes No

If yes, describe the specialized or unique accounting practices:

Are there specialized or unique reporting requirements that apply to the industry?

Yes No

If yes, describe the reporting requirements:

What are the principal trade organizations that relate to the entity's industry?

What trade publications do the above organizations offer?

Are any engagement team members also members of the trade associations?

Yes No

Have the available publications been read or reviewed periodically (by engagement team members)?

Yes No

Are there any applicable regulatory authorities? Yes No

If yes, list and describe the type of oversight provided:

Does the regulatory authority provide:

Publications (regulations, newsletters, other) Describe: _____

Web site Address: _____

Has the firm read or reviewed periodically the available publications and/or web sites?

Yes No

What are the major laws and regulations that are applicable to the industry/entity?

Are there other political, economic or social factors that are peculiar to the industry?

Yes No

If yes, describe:

What financial statement risks exist related to industry, regulatory and other external factors?

For each identified risk, indicate the intended response:

- Overall response: ___ More experienced staff
 ___ Higher degree of professional skepticism
 ___ Interjection of unpredictability

Specific response (modification of the nature, timing and extent of procedures):

Nature of the entity

What are the entity's major sources of revenue?

What are the entity's major expenses/expenditures?

What are the entity's major assets?

What are the entity's major liabilities?

What are the entity's significant contracts?

How and in what form does the entity finance its activities (e.g., loans, grants, contributions, equity)?

How does the entity compensate its employees? What employee benefits are provided?

Does the entity have any major customers (taxpayers)? Yes No
If yes, identify:

Does the entity have any major suppliers? ___ Yes ___ No
If yes, identify:

Does the entity have an investment policy? What kind of investments does the entity make?

Does the entity engage in derivative or hedging activity? ___ Yes ___ No
If yes, describe the nature and purpose of derivative or hedging activities:

Are there estimates in the financial statements that are significant? ___ Yes ___ No
If yes, identify the estimates and describe the process by which estimates are made:

What are the entity's significant accounting policies?

Are there transactions with related parties? ___ Yes ___ No
If yes, describe the related parties, the nature and purpose of the transactions:

Describe the entity's chief accounting person:

Name _____
Title _____
Education _____
Other training _____
Other credentials _____
Years experience: Overall _____ This position _____
Previous positions:
 In this entity _____
 In other entities _____
Reference material consulted _____
Knowledge of applicable GAAP:
 ___ Extensive ___ Moderate ___ Limited

Ability to prepare:
Financial statements:
 ___ Competent ___ Limited ___ Computer generated only
Notes to financial statements:
 ___ Competent ___ Limited ___ No ability
Knowledge of applicable laws and regulations:
 ___ Extensive ___ Moderate ___ Limited

Other information (such as the use of outside CPA or consultant):

What types of misstatements are:

Known to exist in previous financial statements:

Expected to occur in the current financial statements:

What types of noncompliance (direct and material laws and regulations) are:

Known to exist in previous financial statements:

Expected to occur in the current financial statements:

Have previous audits of this entity resulted in other than unqualified opinions?

Yes No

If yes, describe the reasons:

Conclusion

What financial statement risks exist related to the nature of the entity?

For each identified risk, indicate the intended response:

- Overall response: More experienced staff
 Higher degree of professional skepticism
 Interjection of unpredictability

Specific response (modification of the nature, timing and extent of procedures):

Objectives and strategies and related business risks

What goals and objectives have those charged with governance and/or management established?

What strategies have been established in order to accomplish those goals and objectives?

How do management and those charged with governance keep abreast of changes in the industry and identify risks to its goals and objectives (such as reading trade journals, newsletters, attendance at trade association meetings or conventions)?

Have management and those charged with governance identified specific business risks?

Yes No

If yes, describe those risks:

What action have management and those charged with governance taken with respect to identified risks?

Conclusion

What financial statement risks exist related to objectives, strategies and related business risks?

For each identified risk, indicate the intended response:

- Overall response: ___ More experienced staff
 ___ Higher degree of professional skepticism
 ___ Interjection of unpredictability

Specific response (modification of the nature, timing and extent of procedures):

Measurement and review of the entity's financial performance

In general, how does management monitor its financial performance? How does management determine whether things are getting better or worse? What reports, statistics, or key indicators are used?

Conclusion

What financial statement risks exist related to measurement and review of the entity's financial performance?

For each identified risk, indicate the intended response:

- Overall response: ___ More experienced staff
 ___ Higher degree of professional skepticism
 ___ Interjection of unpredictability

Specific response (modification of the nature, timing and extent of procedures):

Internal control

The control environment

Describe the activities of those charged with governance:

Meeting frequency:	___ Monthly	___ Quarterly	___ Ad hoc
	___ Other _____		
Follow an agenda?	___ Yes		___ No
Keep minutes of meetings?	___ Yes		___ No
Approve minutes of prior meetings?	___ Yes		___ No
Review financial statements?	___ Yes		___ No
Review budget comparisons?	___ Yes		___ No
Inquire about:			
Unusual items?	___ Yes		___ No
Budget variances?	___ Yes		___ No
Approve all expenses?	___ Yes		___ No
Approve major/unusual expenses?	___ Yes		___ No
Hear report from management?	___ Yes		___ No

Have those charged with governance established formal (written) policies regarding:

- ___ Ethical and behavioral standards?
- ___ Acceptable business practices?
- ___ Conflicts of interest?
- ___ Prohibited transactions?
- ___ Investments?
- ___ Other?

[Attach copies or excerpts of written policies.]

If there are no formal (written) policies, how do those charged with governance communicate the above matters?

How do those charged with governance oversee the financial reporting process?

- ___ Review of financial statements at regular meetings
- ___ Inquiries about financial statements at regular meetings
- ___ Inquiries about budget variances at regular meetings
- ___ Meetings with external auditors ___ annually ___ periodically ___ ad hoc

Are there committees of those charged with responsibility for aspects of financial reporting, such as an audit committee or executive committee? Yes No
If yes, describe the makeup of the committee and its responsibilities:

How are new employees oriented? How and to what degree are new employees made aware of ethical and behavioral standards?

Has management made conservative decisions with regard to:

Accounting policies? Yes No

Accounting estimates? Yes No

Given the size of the entity and its budget, has management attempted to hire the most competent persons for accounting and administrative positions? Yes No

Does management provide (or offer) employees with the necessary training (on matters such as accounting or compliance with laws and regulations) to perform in a competent manner? Yes No

Are employees' performances evaluated on a regular basis? Yes No

When necessary, does management apply appropriate discipline for inappropriate actions or behavior? Yes No

To the extent possible, has management attempted to adequately segregate incompatible duties and responsibilities? Yes No

Where the number of employees does not allow adequate segregation of duties, have compensating controls (such as those controls performed by those charged with governance or other outside parties) been considered and implemented? Yes No

Conclusion

Given the size and complexity of the entity, are the controls related to the control environment:

Suitably designed? Yes No

In place (were they observed)? Yes No

The entity's risk assessment process

In general, are activities by management and those charged with governance adequate to keep them informed about risks to the operating, financial reporting and compliance objectives? [Refer to the activities documented under "Objectives, strategies and related business risks" above.] Yes No

Has management demonstrated the ability to respond to and manage identified risks? Yes No

Conclusion

Given the size and complexity of the entity, are the controls related to the entity's risk assessment process:

Suitably designed? Yes No

In place (were they observed)? Yes No

Information and communication

Are accounting and other important information systems automated? ___ Yes ___ No

If yes, describe the accounting system:

Hardware:

Software and applications:

Does the entity have access to source code? ___ Yes ___ No

Are software manuals kept current? ___ Yes ___ No

Does the accounting software generate sufficient reports to enable management and those charged to make informed decisions? ___ Yes ___ No

What accounting reports are prepared and reviewed and by whom are they reviewed?

Daily:

Monthly:

Annually:

Are backups performed regularly and stored offsite? ___ Yes ___ No

Describe the backup process:

Has management arranged backup facilities in the event of a natural disaster?

___ Yes ___ No

If yes, describe the arrangement:

In general how does management communicate important information to employees, those charged with governance and others?

Meetings of the governing board?	___	Yes	___	No
Generated reports?	___	Yes	___	No
Email?	___	Yes	___	No
Memoranda?	___	Yes	___	No
Staff meetings?	___	Yes	___	No
Bulletin boards?	___	Yes	___	No
Regular/daily interaction/conversation?	___	Yes	___	No
Other? _____	___	Yes	___	No

Conclusion

Given the size and complexity of the entity, are the controls related to information and communication:

Suitably designed?	___	Yes	___	No
In place (were they observed)?	___	Yes	___	No

Monitoring

Are there mechanisms in place that provide employees the opportunity to make management aware of:

Failures in internal control? Yes No

Departures from established controls? Yes No

If yes, describe those mechanisms:

Is management sufficiently involved in the day-to-day operations that it can identify significant variances from expectations and inaccurate financial data? Yes No

Do management and those charged with governance:

Review internal control reports provided by auditors? Yes No

Follow up on corrective action needed? Yes No

Conclusion

Given the size and complexity of the entity, are the controls related to monitoring:

Suitably designed? Yes No

In place (were they observed)? Yes No

Control activities

Based on your understanding of the entity and its environment, including controls, thus far, identify the **significant audit areas** and the reasons why those areas are significant. An audit area may be significant because of:

1. The volume of transactions processed
2. The dollar amounts of the transactions or balances (relative to other items in the financial statements)
3. An identified fraud risk
4. An identified other (error) misstatement risk.

<u>Audit area</u>	<u>Significant audit area? (Yes or No)</u>	<u>Reason(s) (# from above)</u>
Cash (receipts and disbursements)		
Investments		
Receivables and revenues		
Inventories		
Fixed assets and accumulated depreciation		
Other assets		
Accounts payable and related expenses/expenditures		
Other current liabilities		
Long-term debt		
Equity		
Cost of revenues		
Payroll		
Taxes and related assets/liabilities		
Other expenses		
Laws and regulations		
Other (describe)		

For each area that is identified as a significant audit area, in the pages that follow, document your understanding¹ of the:

- Flow of transactions from their inception to their inclusion in the financial statements², and
- The control activities that are designed to prevent or detect and correct misstatements that may occur.

¹ If the understanding is contained in previous documentation, it may be attached or simply referenced.

² This information may be in narrative, flowchart or walkthrough.

NARRATIVE DOCUMENTING THE FLOW OF TRANSACTIONS

AUDIT AREA _____

Describe how and by whom transactions are initiated:

Describe the documents that are created in the process:

Describe any subsidiary records that are affected by the process:

Identify the general ledger accounts that are affected:

Describe how the transactions are ultimately included in the entity's financial statements:

Control activities – cash receipts and disbursements

Control policy or procedure	Yes	No	Observed?	Suitably designed?
Management and/or those charged with governance review the entity's financial statements on a periodic basis and investigate significant variances from budgets and expected results				
Delinquent receivables are investigated				
The accounts receivable are reviewed and reconciled to the general ledger				
Cash is collected by persons who cannot: <ul style="list-style-type: none"> • Post cash receipts • Authorize write-offs or adjustments of delinquent accounts • Reconcile bank accounts • Edit the receivables master file • Process customer service calls and complaints • Investigate discrepancies or issues related to revenue 				
Cash receipts are posted to accounts receivable by persons who cannot: <ul style="list-style-type: none"> • Authorize write-offs or adjustments of accounts receivable • Edit the receivables master file • Process customer service calls and complaints • Investigate discrepancies or issues related to revenue • Open the mail or copy checks received • Prepare deposits • Deposit cash receipts • Reconcile bank accounts 				
Prenumbered receipts are effectively used and controlled				
A list of daily cash receipts is compared to validated deposit slips by persons who do not post cash receipts				
Cash receipts (restricted revenue) are deposited in separate bank accounts when legally or contractually required				

Control policy or procedure	Yes	No	Observed?	Suitably designed?
Cash receipts are deposited intact promptly or stored in a secure location until deposited				
Cash funds on hand are stored in a secure location and kept independent of mail receipts				
Bank reconciliations are prepared and reviewed on a timely basis				
Individuals who open mail cannot: <ul style="list-style-type: none"> • Initiate shipping documents • Prepare deposits • Deposit cash receipts • Reconcile bank accounts • Investigate discrepancies or issues related to cash • Maintain the cash receipts journal • Post journal entries to the general ledger 				
Individuals who deposit cash receipts cannot: <ul style="list-style-type: none"> • Authorize shipments • Initiate shipping documents • Reconcile bank accounts • Investigate discrepancies or issues related to cash • Maintain the cash receipts journal • Post journal entries to the general ledger. Individuals who reconcile bank accounts cannot: <ul style="list-style-type: none"> • Investigate discrepancies or issues related to cash • Maintain access to cash 				

Control policy or procedure	Yes	No	Observed?	Suitably designed?
Individuals who investigate discrepancies or issues related to cash cannot: <ul style="list-style-type: none"> • Maintain the cash receipts journal • Post journal entries to the general ledger • Monitor suspense or clearing accounts usage • Maintain the chart of accounts • Edit transactional data • Approve edits of transactional data. 				
Purchase order, receiving report, and invoice are matched and cancelled prior to payment				
Management reviews supporting documentation before approving payments				
Accounts payable detail is reviewed and reconciled to the general ledger				
Individuals who review, authorize, or sign checks cannot: <ul style="list-style-type: none"> • Initiate checks for expenditures • Prepare checks • Mail checks • Edit the vendor master file • Investigate discrepancies or issues involving expenditures • Open the mail or copy checks received • Reconcile bank accounts. 				
Checks are prenumbered, the sequence is accounted for regularly, and unissued checks are controlled and kept in a secure location				
Purchasing documents (e.g., purchase orders, receiving reports) are prenumbered, the sequence is accounted for, and unissued forms are controlled				
The check signer reviews all supporting documentation prior to signing a check				

For any “NO” answers above, describe any compensating controls, including activities by management, those charged with governance or others, and what procedures were applied to the compensating controls (such as inquiry, inspection, observation or reperformance):

Consider whether any “NO” answers which are not mitigated by compensating controls constitutes a significant deficiency or material weakness in internal control that should be reported to management and those charged with governance.

Control activities – _____

Control policy or procedure	Yes	No	Observed?	Suitably designed?

For any “NO” answers above, describe any compensating controls, including activities by management, those charged with governance or others, and what procedures were applied to the compensating controls (such as inquiry, inspection, observation or reperformance):

Consider whether any “NO” answers which are not mitigated by compensating controls constitutes a significant deficiency or material weakness in internal control that should be reported to management and those charged with governance.

General fraud controls

Control policy or procedure – Does management -	Yes	No
<p>Control the mail? In small entities, the owner or management should either personally pick up the mail, or have the mail picked up by an employee who has no responsibilities related to the handling or recording of deposits, accounts receivable records or revenues. All remittances should be directed to a post office box. Limiting access to the entity’s mail is essential in preventing the unauthorized negotiation of cash receipts.</p>		
<p>Control the bank statements? Similarly, the owner/management should personally pick up the entity’s bank statements directly from the bank, or have them picked up by an employee who has no related responsibilities and delivered to the owner/manager unopened. Owner/management should review the contents of the statements before they are reconciled. Specific items that management should be alert to and investigate include:</p> <ul style="list-style-type: none"> • Missing checks • Checks issued out of sequence • Unknown payees • Checks that appear to have been altered • Checks not signed by authorized signatories • Other unusual items 		
<p>Control the accounts receivable? Owner/management should limit access to accounts receivable records, and in particular, the ability to issue credit memoranda, discounts and refunds. Accounts receivable detail ledgers should be balanced with the control account at regular intervals and any differences should be investigated promptly. Only owner/management should be authorized to charge off accounts deemed uncollectible. Any discrepancies reported by customers should be investigated promptly. Aged accounts should be reviewed monthly and past due accounts investigated.</p>		
<p>Control the inventory? Owner/management should carefully monitor gross profit, and investigate any unexpected variances. Access to inventories should be limited as much as possible, and the use of surveillance equipment may deter inventory theft. If a perpetual inventory is used, periodic counts should be performed at regular intervals for comparison with the perpetual records.</p>		
<p>Control the accounts payable? Establish and monitor approved vendor lists. Owner/management should periodically review the list of approved vendors, being alert to:</p> <ul style="list-style-type: none"> • Unknown vendors • Vendors with names similar to other known vendors • Vendors with no physical address or telephone number • Vendors whose addresses match employee addresses 		
<p>Limit the number of authorized check signers? If possible, only the owner/manager should be authorized to sign checks. If not possible, consider requiring two signatures on checks, at least those over a specified amount. The use of facsimile signatures should be avoided if at all possible. <u>Never</u> sign checks in blank. Review supporting documentation when checks are signed and investigate any discrepancies.</p>		

Control policy or procedure – Does management -	Yes	No
<p>Account for sequences? Whether it is checks, invoices, credit memoranda, receiving reports, shipping documents, or other prenumbered items, all sequences should be accounted for. Voided documents should be defaced to prevent unauthorized use and retained to complete sequences.</p>		
<p>Control general journal entries? Owner/management should either make or personally review and approve all general journal entries. Supporting documentation should be reviewed before approving general journal entries. In particular, the following items should be investigated:</p> <ul style="list-style-type: none"> • Entries made to unrelated accounts • Entries made to receivables or revenues at or near the close of a period • Entries made by persons whose responsibilities are not consistent with the accounts being adjusted 		
<p>Monitor exception reports? Unprocessed transactions should be carefully examined for propriety. This includes revenues, expenses, purchasing and payroll transactions.</p>		
<p>Establish a budget? Owner/management should establish an operating budget and monitor actual results monthly. Any significant variances should be investigated.</p>		
<p>Establish reasonable performance targets? Setting incentive compensation arrangements at unrealistic performance levels may encourage misstatement of financial results.</p>		
<p>Perform thorough background checks on all new employees? Call former employers and educational institutions for verification of previous employment and education. Beware of "gaps" in employment or educational history. Consider obtaining a credit report (if authorized by the candidate) before employment.</p>		
<p>Require uninterrupted vacations for all employees and establish a schedule of rotation of employee responsibilities? More than just good management, rotation of duties provides a strong disincentive to commit fraud. In addition, it provides an opportunity to discover fraud that has already occurred.</p>		
<p>Remain alert to changes in employee attitudes, behavior and lifestyles? Because of day-to-day contact, management is in the best position to observe the unusual – attitudes that are hostile or defensive toward management or the entity in general, changes in behavior that are inconsistent with employees' normal disposition or lifestyles that are not reasonable based on the employees' level of compensation. Matters that may be of particular concern include:</p> <ul style="list-style-type: none"> • Indications of dissatisfaction with compensation, lack of promotion • Indications of gambling • Indications of drug use or excessive use of alcohol • Indications of financial distress • Indications of infidelity • Indications of serious illness • Indications of excessive nervousness • Indications of severe stress 		

Control policy or procedure – Does management -	Yes	No
Provide employees an opportunity to report the occurrence of fraud or other abuse anonymously? Employees are generally more willing to report known or suspected fraud if they do not have to identify themselves. Management can establish hotlines, "suggestion boxes" or other means to enable employees to bring the occurrence of fraud to its attention without requiring employees to give their names.		
Prohibit anyone taking the entity's records from the entity's offices? There is no good reason why any employee should remove the entity's records from its offices. Keeping records away from management's oversight is one way fraud can be concealed.		
Clearly communicate to employees the behavior that is expected of them? Don't depend on common sense. Being specific about what behavior is acceptable (and what is not acceptable) will facilitate termination and legal action if inappropriate behavior does occur.		
Take strong action against employees who commit fraud? Call the police or other law enforcement agency and press charges. Failing to do so sends a message to other employees that management doesn't take fraud seriously.		
Conduct its own activities on a high ethical level? Employees will follow the lead of management, whether that lead is ethical or not. More than what is said or included in a policy manual, the actions of management establish behavioral norms.		
Obtain reasonable fidelity bond coverage? If fraud does occur, insurance coverage is the most likely means of recovery of amounts misappropriated. The amount of coverage should be reviewed periodically for adequacy.		

Note: For any potential fraud controls that are marked "NO", consider whether the absence of that control policy or procedure constitutes a significant deficiency or material weakness in internal control that should be reported to management and those charged with governance.

Annual update to the Understanding of the Entity and Its Environment Including Internal Controls

Name of entity: _____

Audit period: _____

At or near the end of the audit period, have discussions with management, those charged with governance and others considered appropriate. Review the original documentation of the entity and its environment, including internal control. Identify through review of prior year documentation and discussions with management, those charged with governance and others, whether any of the following have occurred:

Activity or change from previous period	Yes	No
Turnover of key personnel		
Turnover of those charged with governance		
Pending or threatened litigation		
Construction of assets		
Leasing of assets		
Substantial loans/refinancing		
Known or suspected fraud/allegations of fraud by others		
Known or suspected illegal acts/noncompliance with laws, regulations, contracts or grant provisions		
New IT applications		
New contracts		
New activities		
Corrective action on prior audit findings related to internal control or compliance with laws and regulations		
Training/continuing education provided to accounting personnel		
New policies or procedures		
Other:		

Note: For any items marked “YES” attach a memorandum that describes the changes that have occurred, the specific risks identified as a result of those changes, and the planned response to those risks. Alternatively, update earlier documentation and attach new information.

