STATE OF GEORGIA
ACCOUNTING PROCEDURES MANUAL

SECTION: FIVE – INTERNAL CONTROLS
TOPIC: RISK ASSESSMENT

INTRODUCTION AND OVERVIEW

Every State organization faces risks from both internal and external sources that must be addressed and assessed. Risks are events that threaten the accomplishment of a State organization's objectives. Risks affect each state organization's ability to maintain, financial strength, positive public image, and the overall quality of its products, services and people. Management cannot prevent all risks from occurring. Management must decide whether to accept the risk, reduce the risk to acceptable levels, or avoid the risk altogether. Risk assessment is the identification, analysis, and management of relevant risks that affect an organization's ability to achieve its objectives.

DEFINING A STATE ORGANIZATION'S OBJECTIVES

A precondition to risk assessment is the establishment of objectives that are linked to the various divisions or major activities within each State organization. An entity's executive director and division directors most often define organizational objectives. Some organizations will have actual mission statements, while others will rely on value statements or standards which staff strive to achieve. Still others will assess their strengths and weaknesses, and this assessment will lead them to an overall strategic plan.

Objectives can be divided into the following three categories:

1. ***Operations objectives*** help staff achieve the organization's basic mission or statutory responsibilities.

2. ***Financial reporting objectives*** pertain to the preparation of reliable financial statements and other financial information.

3. ***Compliance objectives*** include societal obligations as well as operational practices as defined by Federal and State laws and regulations.

Often, objectives overlap, in that by achieving operations objectives an entity may also be meeting their compliance objectives at the same time.

STATE OF GEORGIA
ACCOUNTING PROCEDURES MANUAL

SECTION: FIVE – INTERNAL CONTROLS
TOPIC: RISK ASSESSMENT

EVALUATE & PRIORITIZE THE RISKS RELATED TO THE IDENTIFIED OBJECTIVES

Senior management at each State organization determines how much risk is prudently acceptable and then strives to maintain that level. To assess risk, management should first insure that it has identified all the organizational and operational, financial, and compliance objectives for the entire organization. Management should evaluate each risk they identify in terms of its significance, likelihood, and cause.

> **Significance** is a measure of the magnitude of the effect on an organization if the unfavorable event were to occur. When determining the significance of each risk, management should consider the effect of the risk. The effect is the ultimate harm that may be inflicted on an organization. Management should quantify this, if possible, or at least state the effect in specific terms to help define the significance of the risks.
>
> **Likelihood** is the probability that an unfavorable event would occur if there were no control activities to prevent or reduce the risk from occurring. Management should estimate the likelihood for each identified risk.
>
> Finally, the **cause** of the risk is the reason why an unfavorable event may occur. It is important that management determine the cause of the risk because this information is critical in the ultimate design of the control activities that will effectively limit that risk.

RISK MANAGEMENT/MANAGING CHANGE

Management should provide guidelines as to the level and the kinds of risk that are acceptable and not acceptable. Using these guidelines and the risk assessment information, division heads should determine whether to accept the risk in a given situation, prevent or reduce the risk or avoid the risk entirely. For example, in deciding how to manage the risk over cash operations, division heads should determine whether to accept the risk of loss or misappropriation of cash, establish controls to prevent or reduce the risk to an acceptable level, or decide that the risk is too great and elect not to provide this service, thus avoiding the risk altogether.

Once risks have been identified and evaluated, management decides on the actions necessary to reduce their potential occurrence and significance, and then monitors those conditions to remain aware of changing circumstances. Management tools for an effective monitoring system are dependent upon an information system that accurately captures, processes and reports appropriate data related to the activity being monitored. Management can then analyze events that may lead to a failure to achieve objectives; determine the likelihood that those events will occur; evaluate the probable effect on objectives; and assess the degree to which a risk can be controlled or an opportunity exploited.

Implementation Guidance

Identifying Entity Objectives

1. Identify the objectives of each division or major activity within the State organization. Consolidate the individual division/major activity objectives into an entity-wide document and evaluate to ensure that objectives do not conflict with the entity's strategic plan. **Managers responsible for objectives must support the objectives and be committed to achieving the objectives.** Division/major activity level objectives must include measurement criteria and measurements must be quantifiable. Establish a process of reconciling inconsistent objectives (i.e., division objectives that conflict with the entity's strategic plan). Identify resources needed to achieve the activity level objectives (e.g., appropriations, personnel, facilities, and technology).

2. Periodically evaluate and update these division/major activity level objectives for continued relevance, in light of the State organization's strategic plan.

3. Communicate these objectives to all who are involved in the process of achieving those objectives.

Evaluating and Prioritizing Risks

1. Establish a risk identification and risk assessment plan for the entire State organization. Consider a formal process to include a method of estimating significance of risks, the likelihood of certain risks occurring, and the needed actions.

2. Prioritize the risks identified in some quantifiable manner from risks of least concern to risk of most concern.

STATE OF GEORGIA
ACCOUNTING PROCEDURES MANUAL

SECTION: FIVE – INTERNAL CONTROLS
TOPIC: RISK ASSESSMENT

3. Establish methods for identifying risks arising from external source (i.e., social conditions, political conditions, external laws or regulations, natural events, technology changes, etc.).

4. Establish methods for identifying risks arising from internal sources (i.e., changes in personnel duties, appropriations, information systems, data processing, cash management, etc.).

5. Schedule periodic re-evaluations of risk.

Risk Management

1. **Accepting the risk** - This alternative may be appropriate if the ultimate harm that might result is deemed to be insignificant to the organization or in situations in which the cost of implementing a control would be greater than the benefit derived. Using the example of the cash operations, management may determine that the operations in question represent an immaterial activity that would not result in any undo harm to the organization should cash related to this activity be mishandled. An example of this might be an employee coffee or flower fund. This choice requires no further action by management other than to document their decision.

2. **Prevent or reduce the risk to an acceptable level** - If management cannot accept the current level of risk related to a particular activity, controls have to be implemented to lower that risk. Using the cash operations example, lets assume that a significant amount of cash is handled and loss or misappropriation could effect the future delivery of those goods or services. In this instance, management would have to institute appropriate policies over hiring and recruiting, cash handling and recording, segregation of duties and responsibilities, training of employees, etc. In developing these controls management must identify what the cause of the risk is, determine the cost of controlling the risk vs. the cost of an unfavorable event and prioritize the risk (in other words, decide how to distribute resources among the various control activities used to reduce the risks. The higher the priority, the greater the resources and control activities that should be used to reduce the risk.)

STATE OF GEORGIA
ACCOUNTING PROCEDURES MANUAL

SECTION: FIVE – INTERNAL CONTROLS
TOPIC: RISK ASSESSMENT

3. **Avoid the risk** - Management may decide that the risk or the cost of controlling the risk is too great and elect (if possible) not to continue providing that service. It is unlikely that the cash operations example provided above would result in a decision by management to cease these operations, however State organizations my currently have operations in which this decision might apply.

Managing Change

1. Establish policies and procedures for managing change.
   a. Consider the following:
      * Establish ways to anticipate, identify, and respond to routine events possibly affecting the ability of the organization to achieve its objectives.

      * Involve managers most responsible for the affected activities.

      * All employees should be encouraged to identify and communicate changing conditions or events.

   b. Risks and opportunities related to changes should be addressed at sufficiently high levels in the organization to allow for identification of their full implications and for formulation of appropriate action plans.

2. Establish mechanisms to identify and respond to dramatic changes possibly having a pervasive effect on the organization, demanding attention from top management. In establishing these mechanisms State organizations should consider the following:
   a. Changes in the operating environment (i.e., shifts in the work force, new legislation, external information that reveals major shifts in customer needs or public perception).

   b. New or redesigned information systems.
      * The effects of new systems must be assessed.

      * Appropriateness of existing control activities should be considered prior to development and implementation of new computer systems.

      * Systems development and implementation policies must be adhered to, despite pressures to shortcut the process.

* Consideration should be given to the effect of new systems on information flow and related controls.

* Consideration should be given regarding the effect of new systems on employee training and employee resistance to change.

c. New personnel.
  * Take special action to ensure new personnel understand the organizational culture, so they may perform accordingly.

  * Consider key control activities performed by personnel being promoted or transferred.

d. New services, products, activities, and acquisitions.
  * Strive to reasonably forecast operating and financial results.

  * Strive to ensure that adequate information systems and control activities for any new services, products or activity are available.

  * Develop plans for recruiting and training people with the appropriate expertise to deal with new services or activities.

  * Establish policies and procedures for tracking early results and for modifying processes as needed.

  * Monitor the effects on other organizational programs or activities.

e. Organizational restructuring or reductions.
  * Establish policies and procedures to analyze staff reassignments or reductions for their potential effect on related operations.

  * Establish policies and procedures to ensure that control responsibilities of employees that have been transferred or terminated have been reassigned.

  * Consider the impact on morale of remaining employees after a major downsizing has occurred.

  * Take steps to minimize disruption to essential or continuing services.

* Develop plans for preventing dislocated workers from disrupting service or destroying records.

f. Decentralized operations.

* Senior management should keep abreast of the political, regulatory, business, and social cultures of areas where decentralized operations occur.

* Establish policies and procedures to ensure that all decentralized operations personnel must be made aware of accepted norms and rules of the central office.

* Establish alternative procedures to cover situations in which the activities of the decentralized operations are interrupted.

g. New Technology.

* Establish methods of obtaining information on technological developments through reporting services, consultants, seminars or public/private sector alliances.

* Monitor new technologies and applications.

* Develop mechanisms for taking advantage of and controlling use of new technology applications and for incorporating them into work processes or information systems.

h. Rapid Growth.

* Establish policies and procedures to monitor information system capabilities to ensure that upgrades are scheduled in a prudent manner to accommodate increasing volumes of information.

* Establish policies and procedures for assessing work force needs in operations, accounting and in data processing to keep pace with increased volume.

* Establish policies and procedures for revising budgets and forecasts as needed.

* Establish a process for considering inter-departmental implications of revised unit objectives and plans.

STATE OF GEORGIA
ACCOUNTING PROCEDURES MANUAL

SECTION: FIVE – INTERNAL CONTROLS
TOPIC: RISK ASSESSMENT

(This page was intentionally left blank)