

STATE OF GEORGIA ACCOUNTING PROCEDURES MANUAL

SECTION: FIVE – INTERNAL CONTROLS **TOPIC: CONTROL ACTIVITIES**

INTRODUCTION AND OVERVIEW

Control activities are policies and procedures which help ensure that management's directives are carried out. The need for a control activity is established in the risk assessment process. Control activities are tools, both manual and automated, that help reduce the risks that can impede accomplishment of the State organization's objectives and mission. Where risk assessment has identified a significant threat to the achievement of an objective, there should be a corresponding control activity. If control activities are in place for each significant operation, and if these activities are carried out properly, management can be reasonably confident that the internal control system will provide the necessary assurances.

Types of Control Activities

There are many different descriptions of types of control activities including preventive controls, detective controls, manual controls, computer controls, and management controls. Although these categories are helpful in the discussion of internal controls, the particular category in which a control happens to be placed is not as important as the role it plays in achieving a particular activity's objectives.

The range of control activities that a State organization implements hinges on its mission, size, complexity and degree of risk. Typically, management first establishes policies to define what should be done. When possible, these should be written and available to all employees in a centrally located policies and procedures manual, however, they may be communicated orally. Unwritten policies can be effective where the policy is a long-standing and well-understood practice, and in smaller organizations where communications channels involve only limited management layers and close interaction and supervision of personnel.

Management should closely monitor and evaluate control activities to ensure that they are functioning properly and that their effectiveness is not being compromised by such things as managerial overrides, collusion, or careless judgments.

When designing and implementing control activities, management should try to get the maximum benefit from the control activities it establishes at a reasonable cost. Considerations should include the following:

1. The cost of the control activity should not exceed the cost that would be incurred by the organization if the undesirable event occurred.

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2. Management should build control activities into business processes and systems as the processes and systems are being designed. Adding control activities after the development of a process or system is generally more costly.
3. The distribution of resources among control activities should be based on the significance and likelihood of the risk it is preventing or reducing.

Control activities can be grouped into three broad groups:

1. **Preventive Control Activities** - Control activities that are designed to deter the occurrence of an undesirable event. The development of these controls involves predicting potential problems before they occur and implementing ways to avoid them.
2. **Detective Control Activities** - Detective control activities are designed to identify undesirable events that do occur, and alert management about what happened. This enables management to take corrective action promptly.
3. **Corrective Control Activities** - Corrective control activities are processes that keep the focus on undesirable conditions until they are corrected. They may also help in setting up procedures to prevent recurrence of the undesirable condition.

There is no one control activity that provides all of the answers to risk management problems. In some situations, a combination of control activities should be used, and in others, one control activity could substitute for another. The following are some of the more commonly used control activities. Please be aware that this is not an all inclusive list of alternatives available to management.

1. **Documentation** - involves preserving evidence to substantiate a decision, event, transaction, or system. All documentation should be complete, accurate, and reported promptly. Documentation should contribute to the achieving the State organization's mission, help managers in controlling their operations, and assist in analyzing operations. There are three main areas within an organization where documentation is very important:
 - * Documentation of **critical decisions and significant events made by management** usually result in the use, commitment, exchange, or transfer of resources, such as those contained in strategic plans, budgets and policies. By recording the information related to such events, management creates an organizational history that can serve as justification for subsequent actions and decisions.

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- * Documentation of **transactions** should enable managers to trace each transaction from its inception through its completion. This means the entire life cycle of the transaction should be recorded, including initiation and authorization, processing, and final classification.
 - * The documentation of an organization's **system of internal control** should include the organization's structure, policies, control objectives and control activities.
2. **Approval and Authorization** - Approval is the confirmation of employee decisions, events or transactions based on a review. For example, a manager reviews a purchase request, as required, to determine whether the item is needed. If needed, the manager would sign the request indicating approval of the purchase. Authorization is the power management grants to employees to carry out certain duties. Authorization is a control activity designed to ensure events or transactions are initiated and executed by those approved by management.
 3. **Verification** - Verification is the determination of the completeness, accuracy, authenticity and/or validity of transactions, events or information. This control activity enables management to ensure activities are being done in accordance with directives.
 4. **Supervision** - Supervision is the management or guidance of an activity to help ensure the results of the activity achieve established objectives. Individuals within State organizations that are responsible for supervision should:
 - a. monitor, review and approve, as appropriate, the work of those performing the activity to ensure the work is accurate and that it flows as intended;
 - b. provide the necessary guidance and training to help minimize errors and waste and to ensure that employees understand and follow management directives; and
 - c. clearly communicate the duties and responsibilities assigned to those performing the activities.
 5. **Separation of Duties** - Separation of duties is the division of key tasks and responsibilities among the various employees and subunits of an organization. No one individual should control all the key aspects of a transaction or event. By separating key tasks and responsibilities - such as receiving, recording, depositing, securing, and reconciling assets - management can reduce the risk or error, waste, or wrongful acts occurring or going undetected. For example, in a purchasing cycle separation of duties

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can minimize the risk of inappropriate, unauthorized or fraudulent activities. Specifically, the various activities related to a purchase (e.g., initiation, authorization, approval, ordering, receipt, payment, and record keeping) should be done by different employees or subunits of an organization. **In cases where tasks cannot be effectively separated, management can substitute increased supervision as an alternative control activity that can help prevent or reduce these risks.**

6. **Safeguarding Assets** - To safeguard assets is to restrict access to resources and information to help reduce the risk of unauthorized use or loss. Management should adequately protect the organization's assets, files, documents, and other resources that could be wrongfully used, damaged, or stolen. Management can protect these resources by limiting access to authorized individuals. Access can be limited by various means, such as locks, passwords, and guards. Management should decide which resources should be subject to safeguarding and to what extent. Management should make this decision based on the vulnerability of the items being secured and the perceived risk of loss, and reassess this decision periodically.
7. **Reporting** - Reporting is a means of conveying information. It serves as a control when it prevents or reduces the risk that an unfavorable event will occur. Reporting assists in monitoring when it provides information on such issues such as timeliness, achievement of goals, budget status and employee concerns. Reporting also helps to promote accountability for actions and decisions.

Control Activities for Computer Systems (for the non-systems manager)

There are several additional control activities that are unique to a computer environment. They exist to address the characteristics that distinguish computerized processes from manual processes. These controls apply to all computerized information systems, (mainframe, minicomputer, microcomputer, LANs, WANs, Client Server, Distributed Processing, and other similar environments). Computer control activities are typically categorized as either general or application controls.

- a. **General controls** are those that relate to all activities in the computer environment, including access security over both hardware and electronic files. They often include controls over the development, modification and maintenance of computer programs and the use of, and changes to, data maintained on computer files.

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- b. **Application controls** relate to specific tasks performed by the computer system. Their purpose is to provide reasonable assurance that data entered into the system is properly recorded, processed, and reported.

The field of computer information processing is one of rapid technological change. Changes in technology will change the specific control activities that may be employed and how they are implemented, but the basic requirements of control will not have changed. As more powerful computers place more responsibility for data processing in the hands of end users, the necessary controls related to those activities will have to be constantly reevaluated and modified as necessary. Business Process Re-engineering is becoming more and more common in today's competitive environment. This is usually done by automating system processes resulting in fewer manual interventions and manual controls. Management should constantly be on guard and identify key controls that may have been re-engineered out of a process. When this occurs, management will have to evaluate the impact of the removal of these controls and take appropriate action.

Control Activities for Systems Managers

Systems managers should seek further guidance on information technology security and control measures from sources such as Control Objectives for Information and Related Technology (CobiT) and Systems Auditability and Control (SAC). These resources have been developed to provide generally applicable and accepted standards for good practices for IT controls that provide a reference framework for management, users, and auditors.

Implementation Guidance

1. Develop control activities or technologies to minimize risk.
 - a. Identify significant risk areas and establish control mechanisms to prevent or minimize things going wrong.
 - b. Perform a cost/benefit analysis on control mechanisms to ensure they are cost effective.
 - c. Periodically review control activities to determine whether they should be changed.
2. Establish appropriate written policies and procedures for key activities.
 - a. Keep policies and procedures manuals current.
 - b. Provide employees with access to those procedures related to their jobs.
 - c. Train new employees in the use of the policies and procedures manuals.

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3. Actively apply identified control activities.
 - a. Controls must be applied to the applicable activity as defined and in a consistent manner.
 - b. Appropriate and timely action should be taken on information or exceptions requiring follow-up.
 - c. Supervisory personnel should review the functioning of controls.
 - d. Management should periodically review controls to assess whether they are still valid.

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