Study Unit 3 – Control: Types and Techniques

Pages 88-89, Subunit 3.4, 6.-7.: These edits improve answer explanations and hints for answering questions.

3) Policies must conform with applicable laws and regulations. They should be consistent with objectives and general policies prescribed at higher levels.

4) Policies should be designed to promote the conduct of authorized activities in an effective, efficient, and economical manner. They should provide a satisfactory degree of assurance that resources are suitably safeguarded.

5) Policies should be periodically reviewed. They should be revised when circumstances change.

EXAMPLE
From CIA Exam

One control objective of the financing or treasury cycle is the proper authorization of transactions involving debt and equity instruments. Which of the following controls would best meet this objective?

A. Segregation of responsibility for custody of funds from recording of the transaction.
B. Requiring two signatures on all checks of a material amount.
C. Use of an underwriter in all cases of new issue of debt or equity instruments.
D. Written policies requiring review of major funding or repayment proposals by the board.

Before reading the answer choices (controls), focus on the requirement of the question. It specifically asks for the control related to authorization of transactions.

(A) does not relate to authorization. Segregation of responsibility for custody of funds from recording of the transaction concerns the objective of safeguarding of assets, not authorization.

(B) also does not relate to authorization. Requiring two signatures on all checks of a material amount concerns safeguarding of assets. In most organizations, the authorization occurs at a managerial level above that at which transactions are executed. For example, certain employees may be authorized to make payments up to a certain amount. The second signature is by another employee who thereby confirms that the entity's policies and procedures have been followed.

(C) is incorrect as well. Use of an underwriter is not a control but a business process.

(D) is the correct choice. The control objective of authorization concerns the proper execution of transactions in accordance with management’s wishes. The establishment of written policies for such major decisions as capitalization is a good example of an authorization control.
7. Procedures

a. Procedures are methods employed to carry out activities in conformity with prescribed policies. The same principles applicable to policies also are applicable to procedures. In addition,

1) To reduce the possibility of fraud and error, procedures should be coordinated so that one employee’s work is automatically checked by another who is independently performing separate prescribed duties. The extent to which automatic internal checks should be built into the system of control depends on many factors. Examples are (a) degree of risk, (b) cost of preventive procedures, (c) availability of personnel, (d) operational impact, and (e) feasibility.

2) For nonmechanical operations, prescribed procedures should not be so detailed as to stifle the use of judgment.

3) To promote maximum efficiency and economy, prescribed procedures should be as simple and as inexpensive as possible.

4) Procedures should not be overlapping, conflicting, or duplicative.

5) Procedures should be periodically reviewed and improved as necessary.

EXAMPLE
From CIA Exam

Which of the following describes a control weakness?

A. Purchasing procedures are well designed and are followed unless otherwise directed by the purchasing supervisor.

B. Prenumbered blank purchase orders are secured within the purchasing department.

C. Normal operational purchases fall in the range from US $500 to US $1,000 with two signatures required for purchases over US $1,000.

D. The purchasing agent invests in a publicly traded mutual fund that lists the stock of one of the organization’s suppliers in its portfolio.

Before reading the controls answer choices, reread reconsider the objective of the question. It specifically asks about authorization for a control weakness, not just “good controls” in general. Always keep this in mind as you evaluate the four choices.

(A) is the correct answer, but it might be rejected by an unwary candidate. The purchasing supervisor is the worst person to be authorized to override normal procedures because (s)he has daily oversight of the purchasing process. The immediate supervisor should enforce apply controls, not override them. The authority to override should be placed at least one managerial level above the purchasing supervisor.

(B) is not a weakness. Prenumbered forms are a typical control.

(C) is also not a weakness. Requiring a more stringent authorization procedure for transactions over a certain monetary threshold is a typical control.

(D) is incorrect as well. Mutual funds hold extremely small percentages of any given company’s stock. Any benefit accruing because of mutual fund ownership would be immaterial.
Study Unit 5 – Sampling

Page 133, Subunit 5.4, 3.c.2): This edit removes “not” from the sentence to make it correct.

c. **Ratio estimation** is similar to difference estimation. However, it estimates the population misstatement by multiplying the recorded amount of the population by the ratio of the total audited amount of the sample items to their total recorded amount.

1) Ratio estimation is preferable to MPU estimation when the standard deviation of the distribution of ratios is less than the standard deviation of the sample item amounts.

2) Ratio estimation is preferable to difference estimation when differences are not relatively uniform.