Section 404 audits of internal control and control risk

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Risk assessment is management's identification and analysis of risks relevant to the preparation of financial statements in accordance with GAAP. To respond to this risk assessment, management implements control activities and creates the accounting information and communication system to meet its objectives for financial reporting. Finally, management periodically assesses the quality of internal control performance to determine that controls are operating as intended and that they are modified as appropriate for changes in conditions (monitoring).

All five components are necessary for effectively designed and implemented internal control. 10-13The five categories of control activities are: ? Adequate separation of duties Example: The following two functions are performed by different people: processing customer orders and billing of customers. ? Proper authorization of transactions and activities Example: The granting of credit is authorized before shipment takes place. ? Adequate documents and records Example: Recording of sales is supported by authorized shipping documents and approved customer orders. ? Physical control over assets and records

Example: A password is required before entry into the computerized accounts receivable master file can be made. ? Independent checks on performance Example: Accounts receivable master file contents are independently verified. 10-14Separation of operational responsibility from record keeping is intended to reduce the likelihood of operational personnel biasing the results of their performance by incorrectly recording information. 10-14 (continued) Separation of the custody of assets from accounting for these assets is intended to prevent misappropriation of assets.

When one person performs both functions, the possibility of that person's disposal of the asset for personal gain and adjustment of the records to relieve himself or herself of responsibility for the asset without detection increases. 10-15An example of a physical control the client can use to protect each of the following assets or records is: 1. Petty cash should be kept locked in a fireproof safe. 2. Cash received by retail clerks should be entered into a cash register to record all cash received. 3. Accounts receivable records should be stored in a locked, fireproof safe.