



Statewide Internal Control Guidance

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| Section: Monitoring | Issued Date: 01/31/2017 |
| | Revision Date: 04/01/2022 |

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Overview

Internal controls are a dynamic process that has to be continually adapted to the risks and changes an organization faces. Therefore, monitoring of the internal control system is essential in helping internal controls to remain aligned with changing objectives, environment, laws, resources, and risks. Monitoring also assesses the quality of performance over time and promptly resolves the findings of audits and other reviews. Corrective actions relating to the internal control system are a necessary complement to control activities in order to achieve objectives.

| Component | Principles | Attributes |
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| Monitoring | 16. Management establishes and operates monitoring activities of the internal control system and evaluates the results. | 16.1 Establishment of a Baseline |
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16. Management establishes and operates monitoring activities of the internal control system and evaluates the results.

16.1. Establishment of a Baseline

Concept

A baseline represents the difference between the design of the internal control system (criteria) and the current state of the internal control system at a specific point in time (condition).

Management Responsibilities

- Management establishes a baseline, and uses the baseline as the criteria to evaluate and monitor the condition of the internal control system.
- Management reduces the difference between the criteria and condition, by making changes to the internal control system, in one of two ways:
 - changing the design of the internal control system to better address the objectives and risks of the organization; or
 - improving the operating effectiveness of the internal control system.
- Management, as part of monitoring, also determines when to revise the baseline to reflect changes in the internal control system.

Key Importance to Internal Control

In essence, the baseline consists of issues and deficiencies detected in an organization's internal control system, that identify the need for potential changes to the internal control system.

Example¹

Some tools to assist in establishing the baseline could include:

- Completing and evaluating the Risk Assessment/Control Activities submission.
- Using industry benchmarks, if available.
- Creating and evaluating performance ratios.
- Brainstorming with others.

16.2. Internal Control System Monitoring

Concept

Monitoring can be performed on an ongoing basis and/or in separate evaluations.

Management Responsibilities

- Management monitors the internal control system through ongoing monitoring and separate evaluations.
 - Ongoing monitoring:
 - monitors the design and operating effectiveness of the internal control system as part of the normal course of operations.
 - performed continually.
 - responsive to change.
 - increases objectivity and efficiency by electronically compiling evaluations of controls and transactions.

¹ The examples provided throughout this framework are intended to be a minimum starting point and not an all-inclusive list.

- Separate evaluations:
 - monitors the design and operating effectiveness of the internal control system at a specific time or of a specific function or process².
 - used periodically.
 - may provide feedback on the effectiveness of ongoing monitoring.
 - provides greater objectivity when performed by reviewers who do not have responsibility for the activities being evaluated.
- Management is also responsible for monitoring the effectiveness of internal controls over the procedures performed by service organizations (third parties).

Key Importance to Internal Control

Ongoing monitoring and separate evaluations, or a combination of the two, are used to provide feedback on the effectiveness of the internal control system, including obtaining reasonable assurance of the operating effectiveness of any service organization's (third parties) internal controls.

Examples¹

- Management establishes procedures for ongoing monitoring, which could include:
 - Using automated tools.
 - Performing regular management and supervisory activities.
 - Preparing comparisons.
 - Performing reconciliations.
 - Performing other routine actions.
- Management establishes procedures for separate evaluations, which could include:
 - Performing self-assessments, which could include cross operating unit or cross functional evaluations.
 - Reviewing results from audits and other evaluations that involve the review of control design and direct testing of internal controls.
- Management establishes monitoring activities related to service organizations (third parties) which could include:
 - Testing of the service organizations (third parties)³ internal control system.
 - Using or reviewing work performed by external parties, such as service auditors.
 - Obtaining a report on controls at the service organization (such as a SOC⁴ report).

16.3. Evaluation of Results

Concept

Evaluations assess the results of monitoring activities as compared to the previously established baseline.

¹ The examples provided throughout this framework are intended to be a minimum starting point and not an all-inclusive list.

² The scope and frequency of separate evaluations depend primarily on the assessment of risks, effectiveness of ongoing monitoring, and the rate of change within the organization and their environment. Additionally, the audits and other types of separate evaluations may be mandated by law and are performed by internal auditors, external auditors, the inspectors general, and other external reviewers.

³ The service organization (third party) should prepare a description of all applicable controls with sufficient detail for the user agency to monitor their internal control system.

⁴ SOC (System and Organization Controls) reports are internal control reports on the services provided by a service organization providing valuable information that users need to assess and address the risks associated with an outsourced service.

Management Responsibilities

- Management evaluates and documents the results of ongoing monitoring and separate evaluations to identify internal control issues.
- Management also considers input from external parties to identify issues in the internal control system, such as complaints from the general public or regulator comments.
- Management considers whether current controls address the identified issues and, if necessary, modifies internal controls.
- Management similarly identifies changes in the internal control system that either have occurred, or are needed, because of changes in the organization and their environment.

Key Importance to Internal Control

Monitoring helps to determine the effectiveness of the internal control system, and the results may indicate areas in the internal control system that need improvement. For example, differences between the results of monitoring activities and the previously established baseline may indicate internal control issues, including undocumented changes in the internal control system or potential internal control deficiencies.

Example¹

Some tools to assist in evaluation of monitoring results could include:

- Completing the Risk Assessment/Control Activities submission, and evaluating the residual risk responses.
- Brainstorming with others.
- Reviewing information received from external parties.
- Establishing routine and/or periodic monitoring procedures.

17. Management corrects identified internal control deficiencies on a timely basis.**17.1. Reporting of Issues****Concept**

Timely communication of identified issues to the appropriate internal and external parties, to enable the organization to promptly evaluate those issues.

Management Responsibilities

- Management informs personnel about their role in reporting internal control related issues, and establishes systems to report these issues, including the need for:
 - Identifying internal control issues while performing their assigned internal control responsibilities.
 - Communicating these issues internally to the person in the key role responsible for the internal control or associated process and, when appropriate, to at least one level of Management above that individual⁵.

¹ The examples provided throughout this framework are intended to be a minimum starting point and not an all-inclusive list.

⁵ Depending on the organization's regulatory or compliance requirements, the organization may also be required to report issues to appropriate external parties, such as legislators, and standard-setting bodies that establish laws, rules, regulations, and standards which are applicable to the organization.

- Considering reporting certain issues to the oversight body, depending on the nature of the issues. Such issues may include:
 - Issues that cut across organizational structure or extend outside the organization to service organizations (third parties), contractors, or suppliers.
 - Issues that may not be remediated because of the interests of management, such as sensitive information regarding fraud or other illegal acts.

Key Importance to Internal Control

Internal control issues are properly and timely reported to the appropriate internal and external parties, to enable the organization to promptly evaluate those issues and their impact on the internal control system.

Example¹

Management establishes procedures to allow for the timely reporting of internal control related issues. Some possible ways to do this could include:

- Brainstorming with others as to where reporting requirements for internal control issues may exist (considering Federal Laws, including grant requirements contained in the Uniform Grant Guidance (Title 2 of the U.S. Code of Federal Regulations (CFR) Part 200) or State Laws, etc).
- Reporting internal control issues having residual risk remaining in the organization's Risk Assessment/Control Activities submission.
- Providing training and routine communications to personnel reminding them of their role to identify and report internal control related issues.
- Having hotlines or other methods that allow any personnel to report issues to any level within the organization, including the oversight body.

17.2. Evaluation of Issues

Concept

Evaluations assess the severity of the identified internal control related issue and determines appropriate corrective actions.

Management Responsibilities

- Management evaluates internal control related issues, identified through monitoring activities or reported by personnel.
- Management determines whether any of the identified issues rise to the level of an internal control deficiency⁶, which would require further evaluation and remediation.
- Management determines the appropriate corrective actions, from the type of internal control deficiency, to remediate the internal control deficiency on a timely basis.
- Management assigns responsibility and delegates authority to remediate the internal control deficiency, as appropriate.

¹ The examples provided throughout this framework are intended to be a minimum starting point and not an all-inclusive list.

⁶ An internal control deficiency can be in the design, implementation, or operating effectiveness of the internal control and its related process.

Key Importance to Internal Control

Timely evaluation and documentation of internal control issues assist in determining appropriate corrective actions. Correcting internal control deficiencies on a timely basis helps to ensure operation of an effective internal control system.

Example¹

Some tools to assist in the evaluation of issues could include:

- Completing the Risk Assessment/Control Activities submission, and evaluating the residual risk column for needed corrective actions.
- Brainstorming with others relating to internal control issues.

17.3. Corrective Actions**Concept**

Corrective actions resolve the previously identified internal control deficiencies, including audit findings.

Management Responsibilities

- Management completes and documents corrective actions to remediate internal control deficiencies on a timely basis.
- Management, or the oversight body (depending on the nature of the deficiency), oversees the prompt remediation of deficiencies. Corrective actions are communicated to the appropriate level of the organizational structure and authority is delegated to the appropriate personnel for completing corrective actions.
- Management, with oversight from the oversight body, monitors the status of remediation efforts so that they are completed on a timely basis.

Key Importance to Internal Control

Corrective actions of previously identified internal control issues, including audit findings, begins when audit or other review results are reported to management. The issues and findings are completed only after action has been taken that corrects identified deficiencies, produces improvements, or demonstrates that the findings and recommendations do not warrant management action.

Examples¹

- Management responds to identified internal control deficiencies. Some possible ways to do this could include:
 - Establishing appropriate control activities.
 - Implementing mitigating controls (such as a secondary review).
 - Rearranging job responsibilities.
- Some possible ways the oversight body oversees could include:
 - Having periodic meetings and other communications with management.
 - Reviewing management's action taken.

¹ The examples provided throughout this framework are intended to be a minimum starting point and not an all-inclusive list.