STATE OF GEORGIA
ACCOUNTING PROCEDURES MANUAL

SECTION: FIVE – INTERNAL CONTROLS
TOPIC: MONITORING

INTRODUCTION AND OVERVIEW

Monitoring is the assessment of internal control performance over time. It is accomplished by ongoing monitoring activities and by separate evaluations of internal control such as self-assessments, peer reviews and internal audits. The purpose of monitoring is to determine whether internal control is adequately designed, properly executed, and effective. Internal control is adequately designed, and properly executed if all five of the internal control components (control environment, risk assessment, control activities, information and communication, and monitoring) are present and functioning as designed. Internal control is effective if management has reasonable assurance that:

* they understand the extent to which operations objectives are being achieved;
* published financial statements are being prepared reliably; and
* applicable laws, regulations and provisions of contracts are being complied.

While internal control is a process, its effectiveness is an assessment of the condition of the process at one or more points in time. Just as control activities help to ensure that actions to manage risks are carried out, monitoring helps to ensure that control activities and other planned actions that effect internal control are carried out properly and in a timely manner and that the end result is effective internal control. Ongoing monitoring activities include various management and supervisory activities that evaluate and improve the design, execution, and effectiveness of internal control. Separate evaluations, such as self-assessments and internal audits, are periodic evaluations of internal control components resulting in a formal report on internal control. Staff from various departments/major activity centers perform self-assessments; internal auditors who provide an independent appraisal of internal control perform internal audits.

Management's role in the internal control system is critical to its effectiveness. Managers, like auditors, don't have to look at every single piece of information to determine that the controls are functioning and should focus their monitoring activities on high-risk areas. The use of spot checks or other techniques can provide a reasonable level of confidence that the controls are functioning.

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Who Monitors Internal Controls?

Everyone within an organization has some responsibility for monitoring. The position a person holds in the organization helps to determine the focus and extent of these responsibilities. Therefore, the monitoring performed by staff persons, supervisors, mid-level managers and executive managers will not have the same focus.

The primary focus on staff should be on monitoring their own work to ensure it is being done properly. They should correct the errors they identify before their work is referred to higher levels for review. Management should educate staff regarding control activities and encourage them to be alert to and report any irregularities. Because of their involvement with details of the organization's daily operations, staff have the best vantage point for detecting any problems with existing control activities.

Supervisors should monitor all activities and transactions in their unit. Their monitoring focus should be on ensuring that:

* control activities are functioning properly;
* the unit is accomplishing its goals;
* the unit's control environment is appropriate;
* communication is open and sufficient; and
* risks and opportunities are identified and properly addressed.

Middle managers monitoring responsibilities should cover the review of how well controls are functioning in multiple units within an organization, and how well the supervisors are performing monitoring in their respective units. These managers' focus should be similar to that of supervisors, but extended to cover all the units for which they are responsible.

Executive management monitoring responsibilities should be similar to those of middle management, except that the executive manager's focus is on major divisions of the organization. Because of this broader focus, executive managers should place even more emphasis on monitoring the organization's achievement of its goals.

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What Should be Monitored?

a. **Control Environment -** Management should monitor the control environment to ensure that managers and supervisors at all levels maintain ethical standards of behavior and promote good staff morale. Managers should also ensure that staff are competent, that training is sufficient and that their management styles and philosophies foster accomplishment of the organization's mission.

b. **Risks and Opportunities** - Managers should monitor the organization's internal and external environment to identify any changes in risks and new opportunities. If changes are identified, managers should take appropriate action to address these new or changed risks and opportunities. Management should recognize that delays in responding to risks could result in damage to the organization; a missed opportunity may result in a loss of new revenue or savings, or may eventually become a risk for the organization.

c. **Control Activities** - Control activities are established to prevent or reduce the risk of an unfavorable event from occurring. If these activities fail, the organization becomes exposed to risk. Control activities can fail when controls are overridden, or when there is collusion for fraudulent purposes. Therefore, management should establish procedures to monitor the functioning of control activities and the use of control overrides. Management should also be alert to signs of collusion. Effective monitoring gives management the opportunity to correct any control activity problems, and to control the risk, before an unfavorable event occurs.

d. **Communication** - Managers should regularly ensure that the people they are responsible for are receiving and sharing information appropriately, and that information is timely, sufficient and appropriate to the user(s).

e. **Mission** - Monitoring activities should include the development and review of operational data that would allow management to determine whether the organization is achieving its mission. By regularly monitoring, management can determine if the organization is accomplishing its mission.

f. **Monitoring Results** - Management should ensure that there are open lines of communication for both staff and management to use. Open communication fosters reporting of both positive and negative results to the appropriate level of management without the fear of reprisal. Management should ensure that it takes the proper actions to address these results.

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Implementation Guidance

1. Establish policies and procedures to enable management to monitor the reliability of reporting systems.
   a. Periodically review reports to ensure data are accurate, reliable, and measuring the appropriate things.
   b. Integrate or reconcile information used to manage operations with data generated by the financial reporting system.
   c. Require operating personnel to "sign-off" on their unit's financial statements.
      * Require accuracy and accountability.
      * Require responsibility for errors.

2. Establish policies and procedures to ensure employees obtain evidence the management control system and its internal controls are functioning, as they carry out their regular activities.
   a. Provide copies of internal audits and other control system evaluation reports to employees.
   b. Involve employees in the creation and evaluation of management control systems.

3. Establish procedures to monitor the extent to which communications from external parties corroborate internally generated information, or indicate management control problems.
   a. Customers implicitly corroborate billing data by paying their invoices or fees.
      * Investigate customer complaints about billings or fees when system deficiencies in the invoicing process are indicated.
      * Investigate the validity and cause of complaints from regulated entities or benefits recipients.

   b. Use communications from vendors and monthly statements of accounts payable as a control monitoring technique.
      * Fully investigate suppliers' complaints of unfair practices by the purchasing department.
      * Encourage feedback from regulators and central service agencies (DOAS, Dept. of Audits, etc.), regarding compliance or other matters reflecting on the functioning of your organization's management control system.
      * Reassess controls that should have prevented or detected problems.

c. Be responsive to internal and external auditor recommendations on ways to strengthen internal controls.
   * Managers with the proper authority should decide which recommendations will be implemented and document those decisions.
   * Follow-up on desired actions to verify implementation.

d. Seek feedback from staff meetings, planning sessions, and other meetings on whether controls are operating effectively.
   * Capture relevant issues and questions raised at staff meetings.
   * Communicate employee suggestions to appropriate levels of management and act upon them as appropriate.

e. Actively monitor staff who regularly perform critical functions.
   * Require employees to sign logs or other evidence that they have performed critical functions.
   * Periodically review critical control activities with the employees responsible for them to ensure they are still applicable and are working well.
   * Periodically have personnel state whether they understand and comply with codes of conduct.
   * Solicit suggestions from employees for improving or changing control activities.

f. Periodically review the effectiveness of internal audit activities (if applicable).
   * Appropriate levels of competent and experienced staff are essential.
   * Internal auditors must have appropriately independent positions in the organizational structure.
   * Internal auditors should have access to top management or the State Organizations governing board.
   * Internal auditors' plans, scope, and responsibilities must be appropriate to the organization's needs.

4. Develop a plan for systematic separate evaluations of the management control system.
   a. Include all appropriate portions of the management control system.
      * The evaluation team should meet together to plan the evaluation process and to ensure a coordinated effort.
      * The evaluation process should be conducted by a manager with requisite authority.

b. Evaluations should be conducted by personnel with requisite skills.
   * Evaluators must have or gain sufficient understanding of the organization's activities.
   * Evaluation methods should include checklists, questionnaires, or other tools as appropriate.

c. Ascertain whether evaluations have adequate scope, depth of coverage, and frequency.
   * Evaluators should have an understanding of how the system is supposed to work.
   * Evaluators should gain an understanding of how the system actually is working.

d. Make policy manuals, organizational charts, operating instructions, etc., readily available to the evaluation team.

e. Document the evaluation process.

f. Measure the evaluation results against pre-established criteria.

5. Develop mechanisms for capturing and reporting identified internal control strengths and weaknesses.
   a. Evaluations performed by internal and/or external parties should be reported to management.

   b. Findings from ongoing monitoring or separate evaluations should be reported to management.

   c. Deficiencies should be reported to the person directly responsible for the activity and to a person at least one level higher in the organization.
      * Specify the types of deficiencies to be reported to more senior management of the governing board.

   d. Take steps to ensure appropriate follow-up actions.
      * Ascertain the validity of the identified transaction or event.
      * Investigate the underlying causes of the problem.
      * Follow-up to ensure necessary corrective action is taken.

   e. Annual reports of your management control system evaluation are to be sent to the State Auditor not later than September 30, reporting on the fiscal year ended the previous June 30.