 **Office of the Washington State Auditor**
Pat McCarthy

Monitoring Internal Controls for ICOs

Presented to the Financial Management Advisory Committee

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Office of the Washington State Auditor

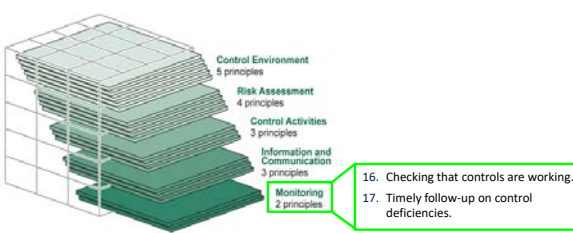
Learning objectives

By the end of the class, we want to answer three questions:

1. What is monitoring?
2. How does monitoring affect audits?
3. How to start developing a monitoring plan?

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① What is monitoring?



Source: GAO | GAO-14-754G

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SAAM 20.28

20.28.10 <small>July 1, 2017</small>	Monitoring overview
	<p>Monitoring is the process of evaluating the quality of internal control performance over time and promptly addressing internal control deficiencies. Monitoring can take the form of ongoing evaluations, which are built into business processes at different levels of the agency, or separate evaluations, which are conducted periodically and vary in scope and frequency, depending on assessment of risks, effectiveness of ongoing evaluations, and other management considerations.</p> <p>Monitoring of the internal control system is essential in helping internal control remain aligned with changing objectives, environment, laws, resources, and risks.</p>
20.28.20 <small>July 1, 2017</small>	Monitoring principles
	<p>There are two principles relating to monitoring activities.</p> <p>16. Management establishes and performs activities to monitor the internal control system and evaluate the results.</p> <p>17. The agency evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action.</p>

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Our audits are not “monitoring”

20.15.20 g **External auditors are not part of an agency's internal control system and cannot be a replacement for or supplement to an adequate system of internal control.** The role of the external auditor is to provide independent accountability and assurance to the public and external stakeholders. However, this independent assurance is also valuable feedback to those charged with governance and agency management.

Internal Controls

Governance (A & B)			Accountability & Assurance Independent Audit (G)
1st Line	2nd Line	3rd Line	
Line Staff & Supervisors (E)	Agency Management (D)	ICO & Internal Audit (C & F)	

Diagram adapted from IIA Position Paper: *The Three Lines of Defense in an Effective Risk Management and Control*

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Why monitoring is an essential element of control

Maintenance

Monitoring keeps systems on track.

- ❑ Counteracts expected breakdown and obsolescence of controls over time
- ❑ Provides resilience by fixing small control failures before they become bigger
- ❑ Providing opportunities to evaluate and improve controls

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Why monitoring is an essential element of control

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

U.S. Government Accountability Office [2014]. Standards for Internal Control in the Federal Government, p. 64
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What does monitoring look like?

- ✓ “Internal audit” reviews by independent, knowledgeable people
- ✓ Independent reviews of summary reports, reconciliation proofs or other documents that demonstrate performance
- ✓ Dashboards
- ✓ Performance measures
- ✓ Standing / periodic meetings (“status reports”)
- ✓ Periodic surveys

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What does monitoring look like?

<p>20.28.30 July 1, 2017</p>	<p>Monitoring versus control activities</p>
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It can be difficult to distinguish between a review that is a control activity and one that is a monitoring activity. Some judgment is involved but determining the intent of the activity can help. An activity designed to detect and correct errors is likely a control activity, while an activity designed to ask why there were errors in the first place and assign responsibility for fixing the process to prevent future errors is likely a monitoring activity. In other words, a control activity responds to a specific risk, while a monitoring activity assesses whether controls within each of the five components of internal control are operating as intended.

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What does monitoring look like?

Control Activity	Monitoring
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② How monitoring affects audits

Sources: COSO and GAO | GAO-14-704G

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Will SAAM 20 updates change our audits? NO

Like before, planning financial, single audit and accountability audits will consider agency monitoring:

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How auditors evaluate monitoring

Documented plan for monitoring to meet SAAM 20?

If Yes, has plan been sufficiently followed? Consider:

- ✓ Extent of coverage compared to assessed risk
- ✓ Actual vs planned coverage
- ✓ Coverage of high risk areas

If Yes, is planned monitoring relevant to audit objective?

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How auditors evaluate monitoring

If Yes, does monitoring plan appear effective? Consider:

- ✓ Are plan and results sufficiently summarized to allow for analysis?
- ✓ Is plan aligned with most recent risk assessment?
- ✓ Does plan ensure high risk areas are reviewed adequately and timely?
- ✓ Does plan include sufficient testing of program change controls, user access controls and key edit checks, calculations or exception reports for significant systems as applicable?
- ✓ Are identified weaknesses or issues corrected or developed as corrective action plans or recommendations?

Advice: If applicable, synchronize with annual internal audit work plan (IPPF 2010).

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How auditors evaluate monitoring

Annual summary of monitoring activity and results documented? Summary should include:

- ✓ List of monitoring activity and results (showing extent of achievement of work plan)
- ✓ List of recommendations / identified weaknesses
- ✓ Status of responses or corrective action from current and prior periods.

Presented to executive management?

Advice: If applicable, synchronize with internal audit reporting (IPPF 2020 and 2060).

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Effect on the audit

What if one of these items is a “no”?

- If nothing: non-compliance with SAAM
- Higher overall risk
- May contribute to specific risks

Note: audit recommendations are for “where you’re at”

How will auditors use agency risk assessment and monitoring?

1. Factor in determining level of audit work needed
2. Identify areas of higher and lower risk
3. Audit may rely on internal work if AU-C 610 requirements are met

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Effect on the audit

<p>AGENCY'S PROGRESS</p> <p>All elements and principles working effectively together.</p>	<p>AUDIT PROGRESS</p> <p>More valuable audit (clearly aligned to agency risks)</p> <p>Less audit issues</p> <p>Lower likelihood and magnitude of issues</p> <p>Lower risk agency (less audit work needed)</p> <p>Less surprises</p>
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③ How to start developing a monitoring plan?

***"Don't do nothing* just because you can't do everything."**

~ Colleen Patrick-Goudreau

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Develop separate or distinguishable plans by objective

(IPPF 2120.A1 and 2130.A1)

Sources: COSO and GAO | GAO-14-704G

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Start at the Agency-wide Level

Sources: COSO and GAO | GAO-14-704G

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Plan to monitor over a period of time

SAAM 20.15.30.a

Risk assessment and internal control monitoring

At a minimum, agencies are required to document risk assessment and internal control monitoring activities for objectives related to financial reporting and federal program compliance. These activities may be done agency-wide at one time or by sections of the agency over a period of time. The agency should consider significance when planning the focus of the risk assessment activities. Likewise, agencies should consider the results of the risk assessment when planning the focus of the monitoring activities. An overall agency plan for risk assessment and internal control monitoring should strive to address high risk areas at least once a biennium.

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Save space in your plans for hot topics

Core areas	<i>Critical controls (high impact to agency) needing annual or biennial review</i>
Cycled areas	<i>Lower impact risks on 4-6 year rotation, based on risk assessment</i>
Hot Topics	<i>Based on risk assessment, external feedback or alignment with other agency initiatives</i>

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Example considerations for Financial Reporting

- Required [GL reconciliations](#)
- For key automated calculations, confirming rate tables when they change and testing calculations
- For key service organizations, reviewing SOC reports and making sure corresponding user agency controls are in place

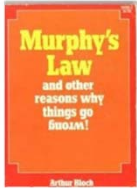
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Development considerations to make monitoring effective

1. Should be **interesting and useful**:
 - ❑ Process and format useful to executive management
 - ❑ Process and format useful to dept and staff
 - ❑ Integrated with process improvements, performance measures, dashboards, staff evaluations and other regular activities
2. Should result in kudos and **corrections**.
3. Should eventually **reduce audit issues** to within tolerances. Audits provide valuable feedback on effectiveness of monitoring.

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In Conclusion



Murphy's Law and other reasons why things go wrong
by Arthur Bloch © 1979

“Everything put together falls apart sooner or later”

- Monitoring is the **maintenance element** to counteract expected breakdown and obsolesce of controls over time.
- Processes should be **useful and insightful** to management and the governing body.
