

# Big Brother is watching... your transactions

“Continuous monitoring” sounds a bit sinister. It’s not – and it can prevent damage to your revenue and reputation. **Michael P Cangemi** explains how this IT solution helps even SMEs keep a closer watch on what’s happening in their businesses

**R**egulatory burdens. Fraud risk. The drive for efficiency. Customer satisfaction. Keeping an eye on everything that’s happening around your business is incredibly demanding. But both revenues and reputation might depend on it.

Take the case of one disgruntled phone company customer’s much-read 2010 letter to *The New York Times*. Travelling to Mexico, her phone had failed to work, a minor inconvenience. Once back home, she realised that she had lost the phone – a further small-time aggravation. But she was then truly incensed to receive a bill from her mobile phone company for more than \$2,000 of mainly fraudulent usage.

As her previous bills over a number of years had all been around \$70, she found it incredible that a technologically adept phone company had failed to monitor and spot an almost 30-fold increase in usage. Result? A large number of NYT readers suddenly knew of the company’s failings, too. As American business magnate Warren Buffett observed, “It takes 20 years to build a reputation and five minutes to ruin it.”

It’s a classic case where continuous monitoring (CM) could have helped.

## WHAT IS CM?

At its simplest, CM is an IT solution that monitors the state of your internal controls. It automatically detects breakdowns, inefficiencies and fraudulent activity, then sends notifications to the relevant stakeholders – often telling them how to remedy the potential errors. (In the case above, it might have flagged unusual account activity and prevented embarrassing publicity.)

CM is often introduced in payment-related areas such as accounts payable

and expenses. Credit card companies use similar technology to spot unusual spending activity. Unsurprisingly, then, a return on investment for CM can be estimated based on cash recoveries. And while many organisations still use recovery audit firms to monitor payments, in-house CM is gaining ground with finance executives because it enables near-perfect recovery rates, with no commissions to consider. Other benefits of adopting CM include the ability to:

- monitor transactions to prevent fraud before it occurs;
- reduce audit and compliance costs; and
- automate the process of monitoring internal controls.

CM is not new. Automated continuous monitoring has a long history in the assurance function and most of its technological underpinnings originate from internal audit. Twenty years ago, for example, vigilant monitoring was a pillar of the framework produced by a US think tank – the Committee of Sponsoring Organisations of the Treadway Commission (COSO) – to define internal controls, following major reforms in corporate financial reporting laws.

The new trend is to integrate CM into operations, moving from snapshot assessments of controls to ongoing monitoring of the internal control environment. The big gain is reaction time. In addition, a use has recently emerged for identification of violations of the Foreign Corrupt Practices Act or the UK Bribery Act. This was brought to light in the recent Peterson case, where a managing director of Morgan Stanley conspired to circumvent the firm’s internal controls in order to transfer a multi-million dollar ownership interest in a Shanghai building to himself



and a Chinese public official, with whom he had a personal friendship. Morgan Stanley was totally exonerated and was praised by the US Securities and Exchange Commission (SEC) and department of justice for having a solid compliance program in place.

A recent study of 11 major organisations by the Financial Executives Research Foundation (FERF) concluded that “leading companies recognise the importance of monitoring, and are

becoming an Orwellian Big Brother for business, too. So how are companies already using CM? And what lessons can we take from them?”

## ELIMINATE DUPLICATES

United Technologies Corporation (UTC) – one of the organisations featured in the FERG research – is a US-centred, high-tech manufacturer with annual revenues of

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\$53bn. Its operating divisions include Carrier, Hamilton Sundstrand, Otis, Pratt & Whitney, Sikorsky, UTC Fire & Security and UTC Power.

UTC’s issue was monitoring the large volume of transactions generated by its various business units. It launched a CM initiative to reduce or even eliminate duplicate payments. The company chose Oversight Systems’ Procure-to-Pay (P2P) module in order to achieve this. This provided 110 predefined, customisable tests called integrity checks (ICs). The P2P module would then analyse data from eight of UTC’s separate systems and generate exceptions when anomalies were found. The initial ICs tested included:

- vendor bank account duplicates;
- vendor duplicates;
- voucher duplicates invoice; and
- payment duplicates.

UTC achieved excellent results. In the first phase, 536 duplicate invoices and 42 duplicate payments were identified and confirmed. But the company learned that the number of ICs run at any given time must be limited and prioritised by risk, because each IC could potentially generate a large number of false-positive exceptions that would then have to be analysed and resolved. Getting feedback from the reviewers and investing time to tune the ICs was also critical in reducing the volume of false positives. The software can also be used to filter out small value

transactions and/or low probability exceptions to reduce the reviewers’ workload.

The UTC experience shows that, as with other major initiatives, commitment from the business units and ongoing communication to key stakeholders are critical – and you must prepare for employee turnover and training.

When deciding whether to deploy new CM modules or new ICs, keep in mind that each new module or IC will force the business unit(s) to take on more exception checking – though, to be fair, this will involve only a few additional people compared with far greater numbers needed for manual exception checking.

As Loretta Cangialosi, senior VP and controller at Pfizer (which uses Overnight Systems for its CM) says: “With CM systems for our travel and entertainment process and three employees, we can review and act on discrepancies identified by continuously monitoring thousands of transactions in a way that would have required at least 30 employees using traditional auditing methods.”

## ADDRESSING LEGACY ISSUES

Metcash is a leading marketing and distribution company operating in wholesale marketing and distribution of food and consumer goods. The company has multiple subsidiaries: IGA Distribution, IGA Fresh, Australia Liquor Marketers and Mitre 10, and more than 5,000 employees and a market capitalisation of approximately \$3.2bn.

Its challenges included a lack of an effective solution to address control weaknesses, many disparate databases and legacy systems and difficulty in managing exceptions due to the huge volume of transactions.

After having a thorough discussion about its challenges with its local reseller, Metcash decided to use CaseWare’s CM solution to monitor its accounts payable (AP), payroll, HR, taxation, accounting and warehouse operations. It was able to monitor all transactions, automatically distribute exceptions to relevant personnel and create a wider window of opportunity to alleviate control breaches and prevent losses.

What were they looking for? AP



monitoring, for example, checked for:

- vendor duplicates;
- invoice duplicate (two invoices to the same client);
- payment duplicates;
- payment vs invoice (ensuring invoice and payment amounts match).

The quantifiable results included enhanced assurance and the ability to rectify issues that led to approximately \$1.8m in savings. Metcash realised that handling exceptions from large volumes of transactions, across multiple business processes, can reap tremendous savings if automated and done continuously. And it learned that user adoption across business units and stakeholders will be higher if monitoring tools work easily with existing systems and applications.

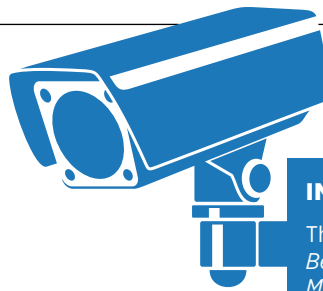
### PROVING THE SME CASE

It's true that SMEs' interest in CM is currently limited – through both lack of familiarity with the concept, and low awareness of the existing tools. However, there are tools well within the reach of smaller companies, as listed in the software tools appendix in the FERF research.

At Etienne Aigner Inc – a luxury fashion accessories subsidiary of LSE-listed small-cap Hartstone Group PLC – we used CaseWare for CM. This is adopted extensively by public accountancy firms, which is how I first discovered it, is easy to use, can run on a desktop and is reasonably affordable.

We employed the tool mostly on an ad hoc basis. For example, when inventory volumes built up – usually indicating slow sales and potential inventory write downs – we used CaseWare's IDEA software to compare inventory-by-style to sales-by-style. The resulting reports were used to curtail future production with better precision, and accelerate mark-downs to speed inventory turnover.

If we questioned a total from a system or on a financial statement, we would use CaseWare-IDEA to add up totals, do basic recalculations and sometimes identify applications issues. We also used it on occasion to check our accounts payable system for duplicate payments – and were planning to evolve it to be an in-the-stack



### IMPLEMENTING CM

The 2011 FERF report – *The Benefits of Continuous Monitoring* – found that each business adopting CM has its own starting point, usually industry- and context-specific. So it's important to start with a roadmap laying out the desired outputs and effects. (And, if budgets allow, the expertise of an external consultant helps.) But some general steps to follow when launching CM include:

#### 1. Evaluate the corporate performance and governance culture of your organisation

Evaluate the tools and technologies available. Identify costs and benefits. Demonstrate how the CM initiative would contribute to achieving superior corporate performance and corporate governance outcomes. Justify the ROI. And secure a critical mass of support among stakeholders in your organisation.

#### 2. Create an implementation strategy

Define the vision and strategy of implementing CM. Specify criteria such as risk exposure, risk appetite and tolerance. Assess the attitudes of affected staff and resources (for example, do they respond well to change?). And set exception reporting parameters.

#### 3. Review progress

Once your CM initiative is up and running, communicate the results to management and key stakeholders – and celebrate instances where it catches something that would otherwise have gone unnoticed. Monitor performance of the CM system. Review findings and validate their currency and reliability. And tweak monitoring frequency or exception reporting thresholds to make the results more meaningful.

## Continuous monitoring is a business operational issue swirling around in auditing and accountancy practices

application for monitoring duplicate payments. All of this for less than \$1,000 in the 1990s – and only slightly more than twice that today.

The results? Improved financial and operational reviews and data analysis, providing a better understanding of operational issues. We learned that there are high-quality, low-cost CM software programmes available for SMEs – and that the possibilities for SMEs are limited only by the creativity of the users.

### GIVE IT A TRY

Continuous monitoring is a business operational issue swirling around in auditing and accounting practices. While internal control is important, I believe financial and operational management should also be more focused on CM as an automated tool for business operational improvements and customer satisfaction – together leading to improved profits. ■

**This article is dedicated to my friend Paul Williams MBCS, FCA, CITP, long-time fellow of ICAEW who inspired and collaborated with me on professional issues.**

#### Further reading

The Committee of Sponsoring Organisations of the Treadway Committee [coso.org](http://coso.org)  
 Financial Executives Research Foundation (FERF) [ferf.org](http://ferf.org)  
 FEI's *Financial Executive* magazine, May 2012: The real benefits of continuous monitoring  
 Internal Audit's Role in Continuous Monitoring, Cangemi, EDPACS 2010 [canco.us](http://canco.us)



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