

INTERNAL CONTROLS TRAINING

Internal Controls

What do you think of when someone mentions Internal Controls?

- Fraud
- Separation of duties
- SOA Reconciliation
- University Audits
- P-Cards
- Article on front page of Ann Arbor News

Internal Control Definition

Internal Control is a process designed to provide **reasonable assurance** regarding the achievement of objectives in the following three categories:

- ❑ **Effectiveness and Efficiency of Operations** - Processes are doing what they are intended to do (i.e., achieving their objectives), and doing so in an efficient manner - - i.e., making good use of available resources.
- ❑ **Compliance with Laws and Regulations** - Actions are consistent with all applicable laws and regulations.
- ❑ **Reliability of Financial Reporting** - Accuracy and reliability of Financial Statements.

Internal Control Framework

Internal Controls Maturity Framework



Central Financial Processes

- Reviewed annually by external auditors
 - Reviewed periodically by internal audit

Unit Financial Functions

- Highly decentralized process with individual control processes
- Relies heavily on institutional knowledge and often undocumented processes
- Oversight may rely on faculty and other non-financial leadership

Optimized Control Environment

- Ongoing integrated process to connect central process owners with Units

Internal Controls Myths and Facts

MYTHS:

Internal control starts with a strong set of policies and procedures.

Internal control: That's why we have internal auditors!

Internal control is a finance thing.

Internal controls are essentially negative, like a list of "thou-shalt-nots."

Internal controls take time away from our core activities of research, instruction, and patient care.

FACTS:

Internal control starts with a strong control environment.

While internal auditors play a key role in the system of control, management is the primary owner of internal control.

Internal control is integral to every aspect of business.

Internal control makes the right things happen the first time.

Internal controls should be built "into," not "onto" business processes.

Risk and Internal Controls

What are risks?

A risk is anything that could jeopardize:

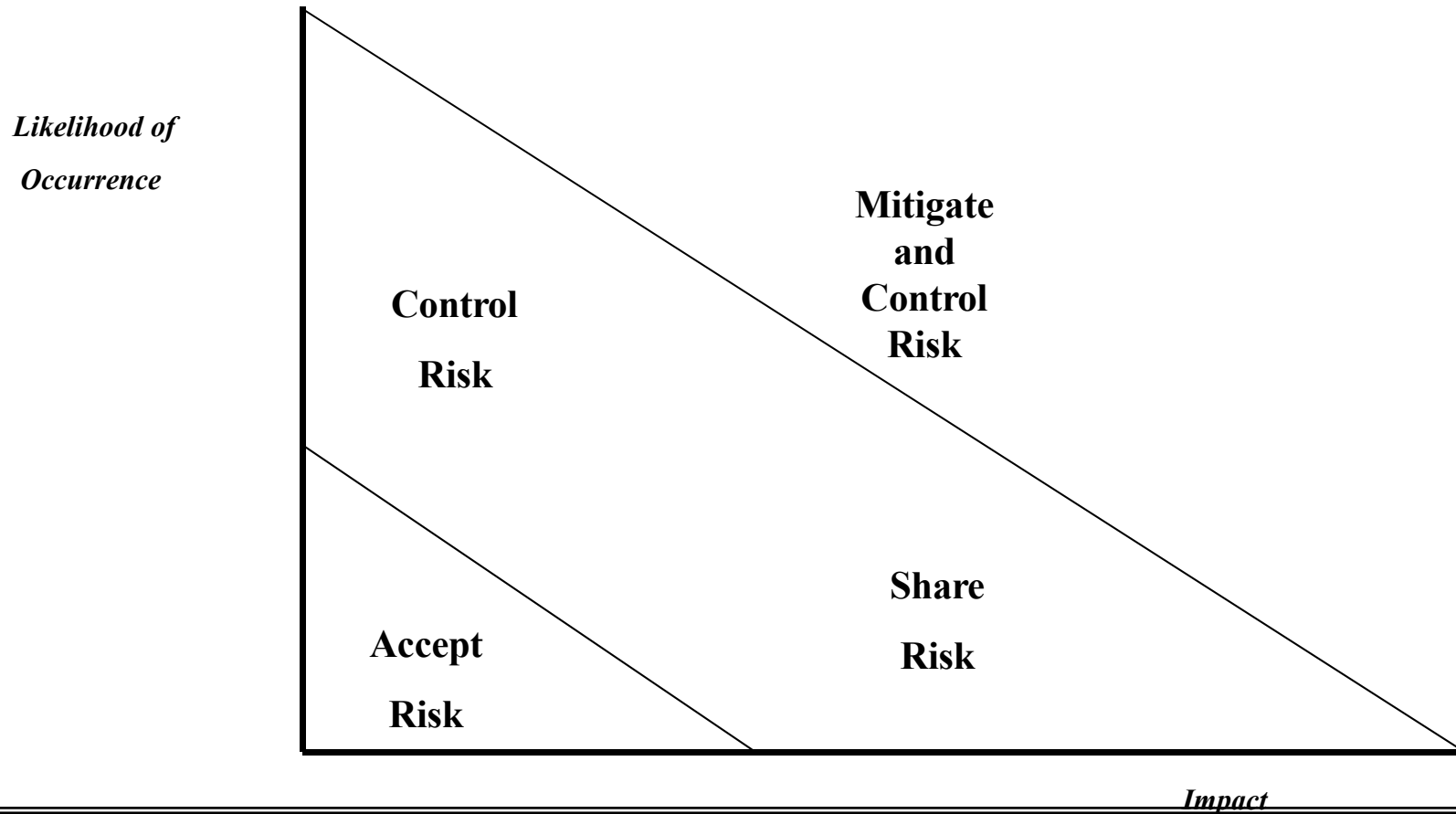
- Achieving our goals
- Operating effectively and efficiently
- Protecting the university's assets from loss
- Providing reliable financial data
- Complying with applicable laws, policies, and procedures

Risk and Internal Controls

Questions to ask yourself:

- What can go wrong?
- How could someone steal from us?
- What policies are we most affected by?
- What types of transactions in our area provide the greatest risk?
- How can someone bypass the internal controls?
- What potential risk areas could cause adverse publicity?

Assessing Risk



Risk and Internal Controls

What could go wrong in your unit?

- Fire breaks out in research lab
- Key local system/application goes down
- Key employee calls in sick
- Media becomes aware of P-Card fraud
- Safety or security incident with faculty/student/staff member overseas
- Cash missing from departmental funds
- Faculty hires family member inappropriately

Top Ten Areas of Decentralized Control/Compliance Attention

Where have there been recent unfortunate publicized events across the country?

1. Use of P-Cards for personal benefit
2. Undocumented/approved compensation and/or benefit arrangements
3. Imprudent travel and entertainment expenses
4. Inappropriate charging of restricted funds (e.g., gifts, grants, etc.)
5. Localized receipt of cash and off book bank accounts
6. Purchasing practices not appropriately followed
7. Untimely or cursory reviews of departmental expense activity
8. Undocumented and/or approved expense transfers
9. Inaccurate account coding of expense and revenue activity
10. International activities not in compliance with policies

* List developed by John Mattie, PwC U.S. Education & Nonprofit Practice Leader – presented at UM Internal Controls Forum in March 2013

Types of Internal Controls

Controls can be either automated or manual

- **Automated Controls** – Incorporated into application logic / algorithms
 - Example: System automatically searches for a matching PO before paying an invoice
- **Manual Controls** – Performed by individuals outside of the system or application
 - Example: Supervisor's signature on P-Card statement

Types of Internal Controls

Controls can be either preventive or detective

- **Preventive Controls** – Built into the process or system to avoid or minimize risk. Helps make processes more efficient and can reduce cost of corrective actions.
 - Example: Access Controls - - Only individuals with approved M1 access can perform transactions in MPathways
- **Detective Controls** – Provides a process assessment to identify potential issues for further review
 - Example: Unit reconciles Gross Pay Register to ensure all transactions are correct
 - Example: Payroll reviews any invalid shortcode charges

Types of Internal Controls

While Automated Controls are generally more effective,
Preventive Controls are typically more efficient

Level of Reliability (Effective)	<i>Automated</i> Detective	<i>Automated</i> PREVENTIVE
	Manual Detective	Manual PREVENTIVE
		Level of Economic Value (Efficient)

Types of Internal Controls

Controls - particularly related to information processing - support the following objectives or assertions:

- | | |
|-------------------------|---|
| <u>C</u> ompleteness | • <u>A</u> ll transactions are processed (once and only once) |
| <u>A</u> ccuracy | • All transactions are processed <u>c</u> orrectly |
| <u>V</u> alidity | • All transactions are authorized or approved by appropriate person |
| <u>R</u> estrictiveness | • Access to certain functions is restricted to appropriate persons |

CAVR and Your Checkbook

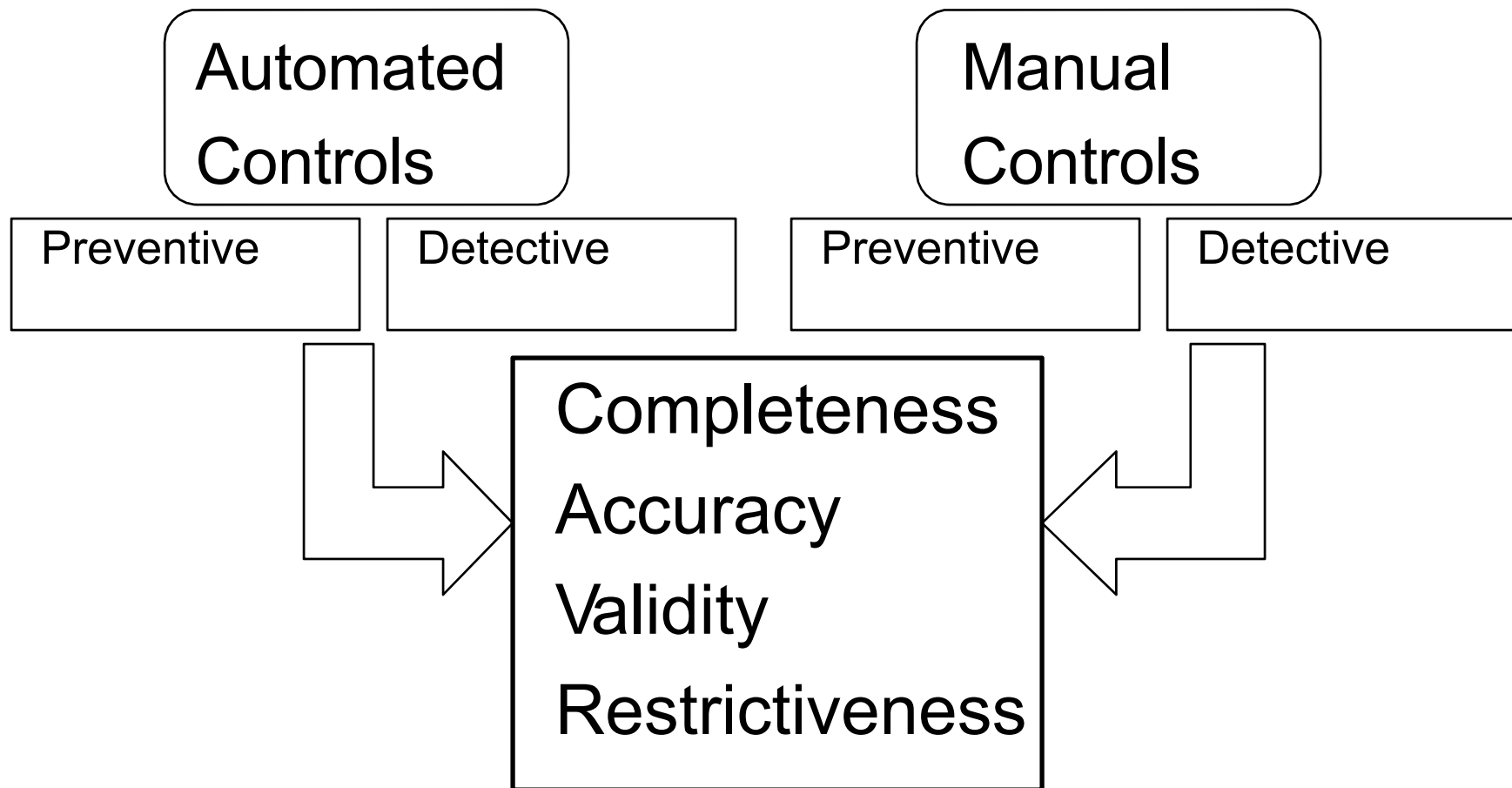
When you reconcile your checkbook every month, you are going through the CAVR steps:

- Completeness • Did the bank process all the checks that I wrote this month?
- Accuracy • Did the bank process all the checks correctly - - the right amount?
- Validity • Were all the checks processed by the bank written by me?
- Restrictiveness • Did someone else have access to my checkbook?

CAVR and the Gross Pay Register

- Completeness • All employees that should be in a unit, are in the unit
- Accuracy • The pay for a new hire starting in the middle of a month is correct
- Validity • Additional pay was approved by appropriate person
- Restrictiveness • Person processing changes in pay is not reconciling GPR

Types of Internal Controls

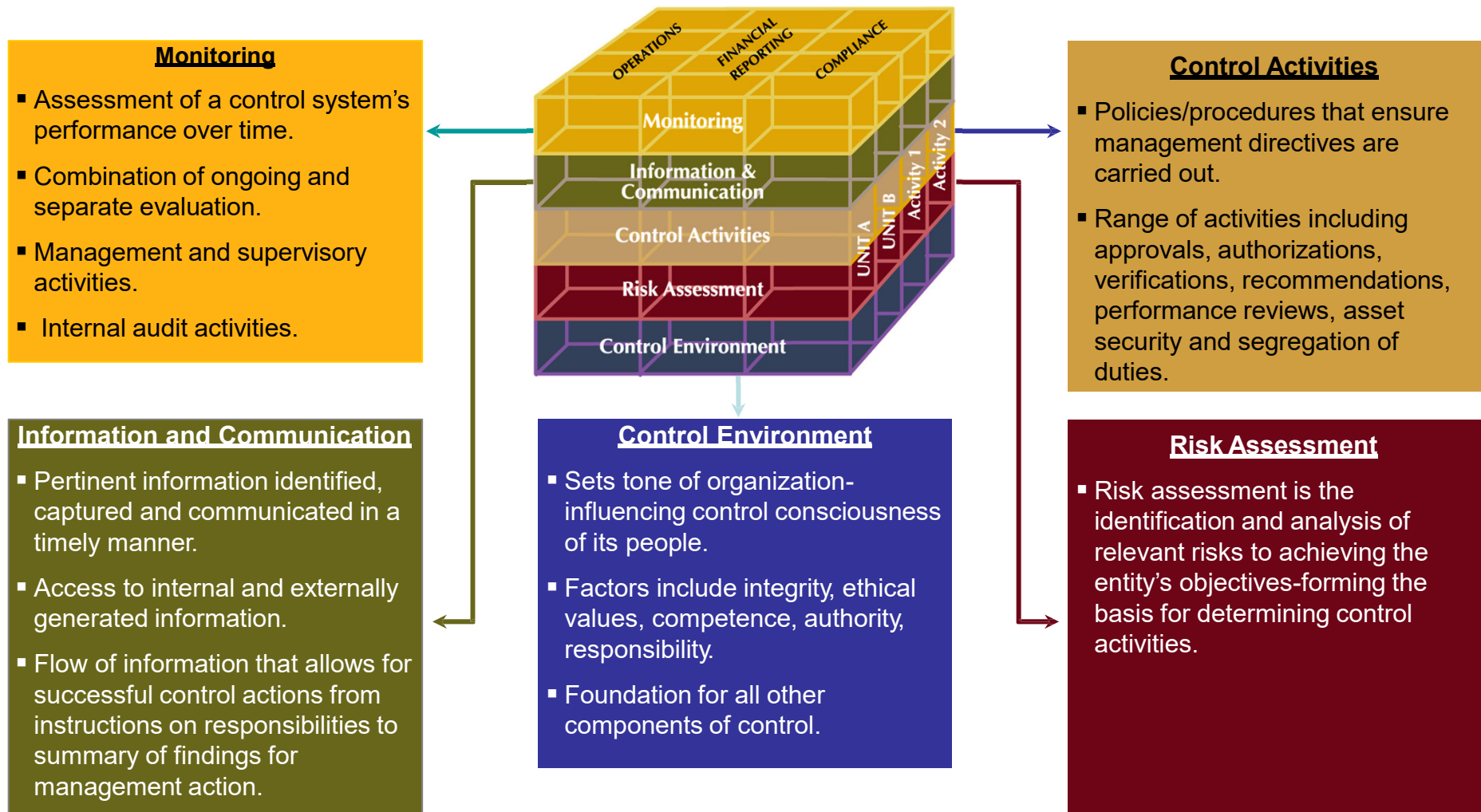


Top Ten Financial Related Audit Findings

Based on FY2018 - FY2019 Financial Related Results

1. Cash Handling – Receiving / Deposits / Refunds
2. Training – Cash / Merchant / Concur Approver
3. Employment – Onboarding & Offboarding / COOP
4. Reconciliation – Credit Card Sales / Cash Logs / SOA
5. Conflict of Interest / Commitment
6. Lack of Documented Policies & Procedures
7. Separation of Duties
8. Employment – Monitoring of Effort Certification
9. Financial Oversight – Management Reports
10. Tracking & Management of Inventory / Assets

The Five Components of a Strong Internal Control Framework



All five components must be in place for internal control to be effective.

Internal Control Framework

<u>Component</u>	<u>General Description</u>	<u>Examples of UM Activity</u>
Control Environment	Sets tone of organization	Standard Practice Guides Statement on Stewardship Finance, Audit and Investment Committee
Risk Assessment	Identification and analysis of relevant risks	Internal Audit Risk Assessment Risk Management, Compliance Offices
Control Activities	Policies and procedures that govern day-to-day activity	P-Card Approvals, SOA reconciliations, separation of duties, written procedures, access controls
Information and Communication	Flow of timely, accessible and pertinent information	Foundations of Supervision, metric reporting, management reviews, websites, annual performance reviews
Monitoring	Assessment of controls	Internal Audit, annual gap analysis, M-Reports, Oversight reports

What is Fraud?

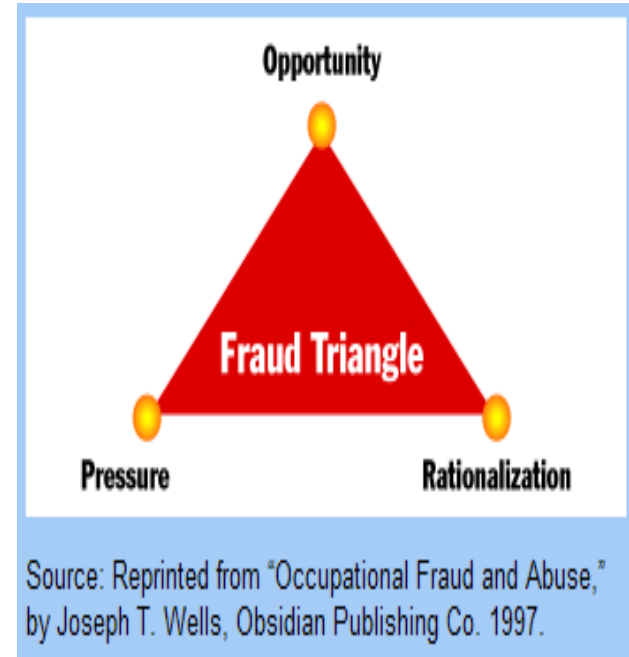
Fraud - Typically requires 3 key elements:

- 1) Did something bad/wrong - -
misrepresentation of facts
- 2) Done intentionally
- 3) Resulted in unauthorized personal gain

Who Commits Fraud?

Those having:

- **Pressure** - Usually caused by financial need or desire for lavish lifestyle
- **Ability to rationalize** – Make excuses and do not think of crime as stealing
- **Opportunity** – Typically arises from weak controls or too much independence/ control given to someone



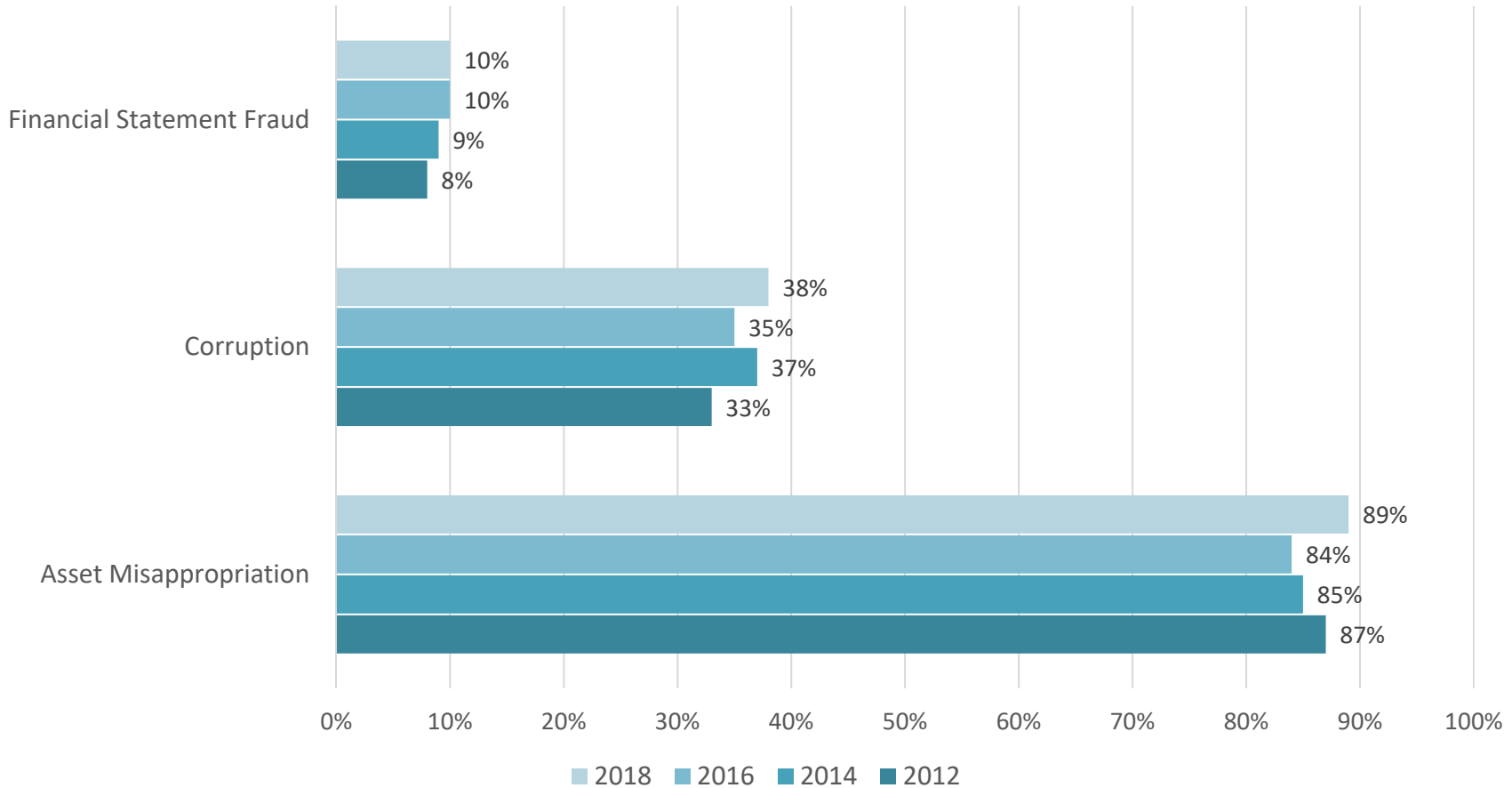
Who Commits Fraud?

- 53% between ages of 31-45
- 69% are Male
- 44% 1-5 yrs experience (\$100k Median Loss)
- 24% >10 yrs experience (\$250k Median Loss)
- 58% referred to law enforcement

Source: 2018 ACFE Report to the Nations on Occupational Fraud & Abuse - study of 2,690 fraud cases

How Occupational Fraud is Committed

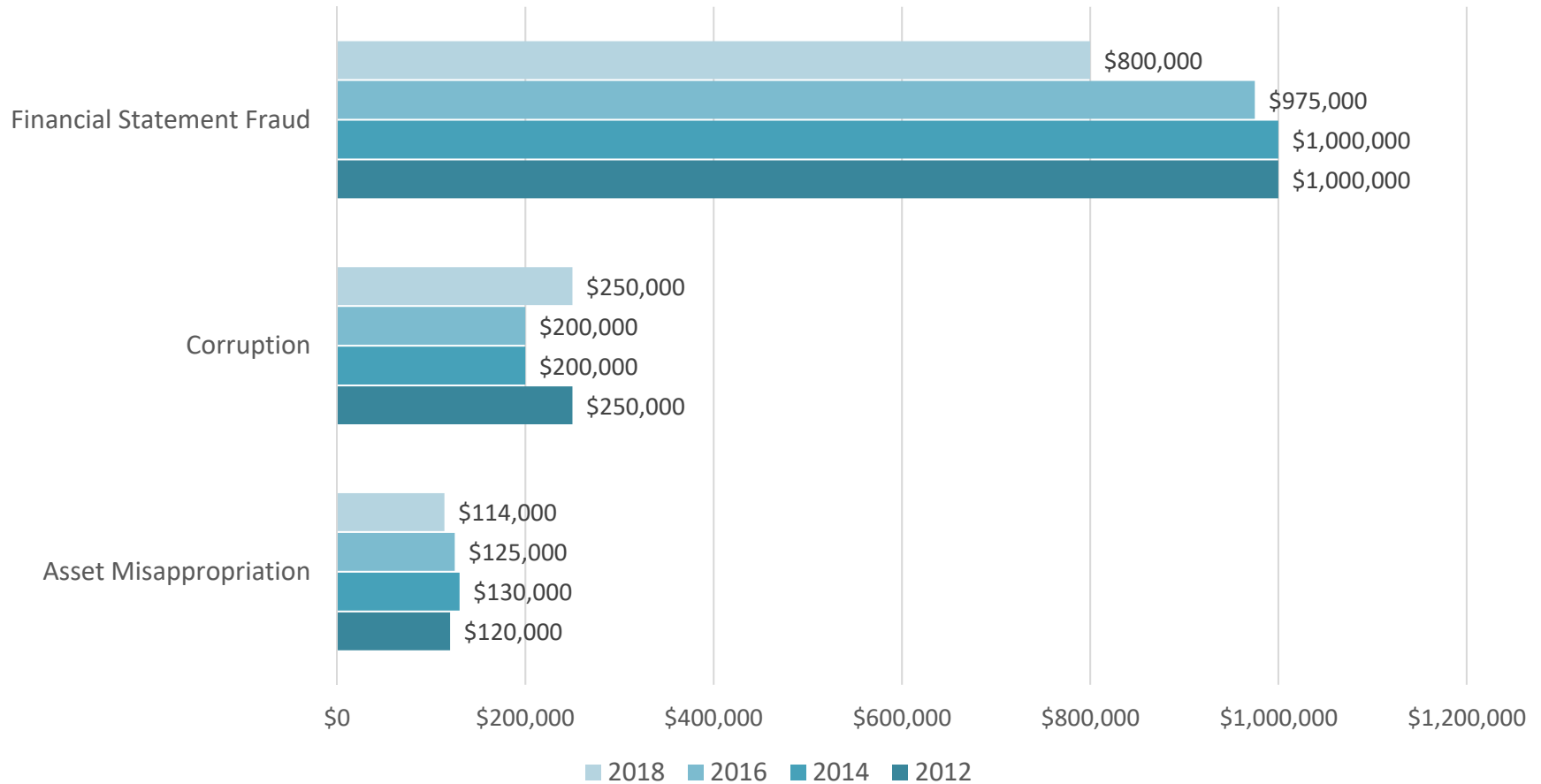
Occupational Fraud by Category – Frequency



Source: 2018 ACFE Report to the Nations on Occupational Fraud & Abuse - study of 2,690 fraud cases

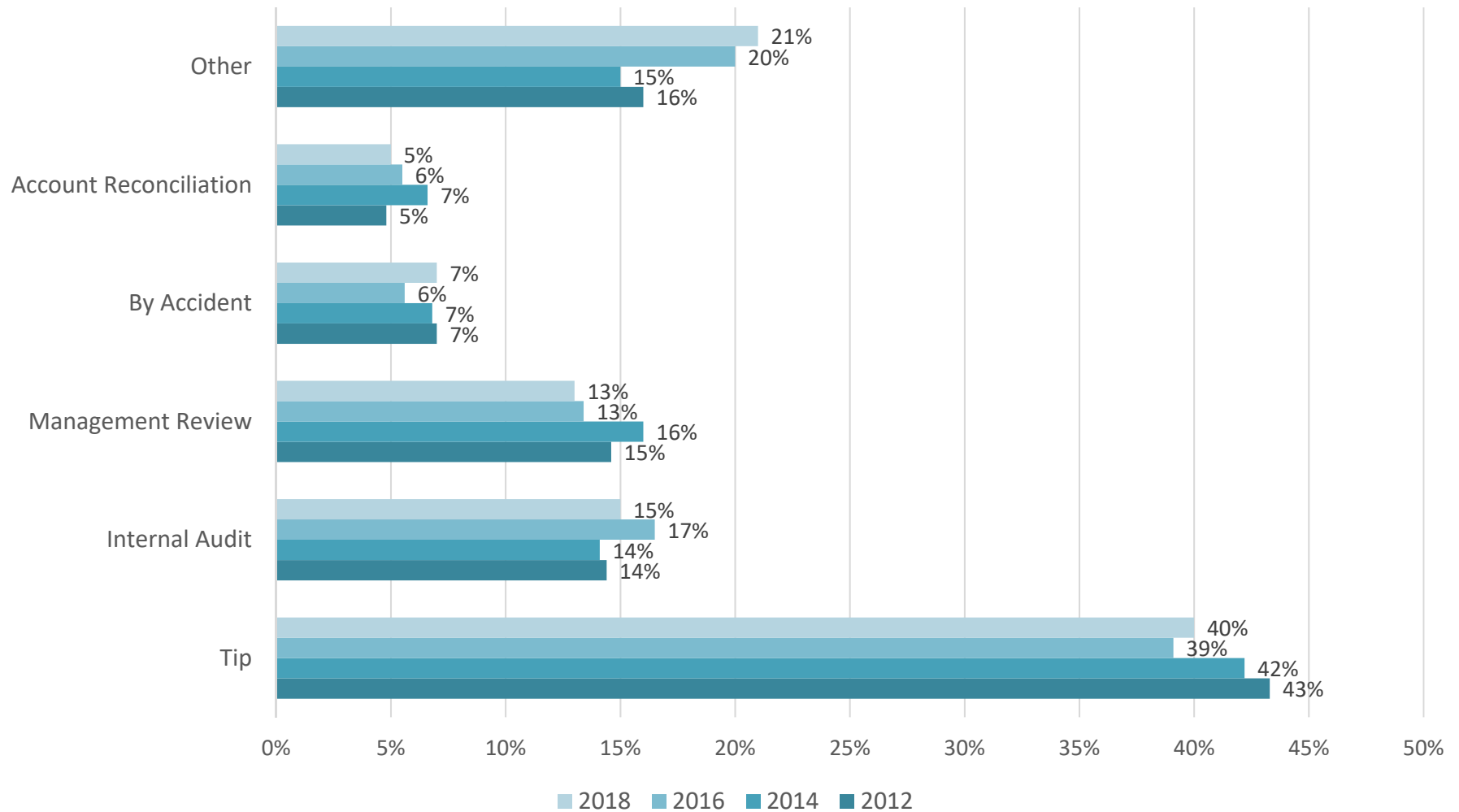
How Occupational Fraud is Committed

Occupational Fraud by Category – Median Loss



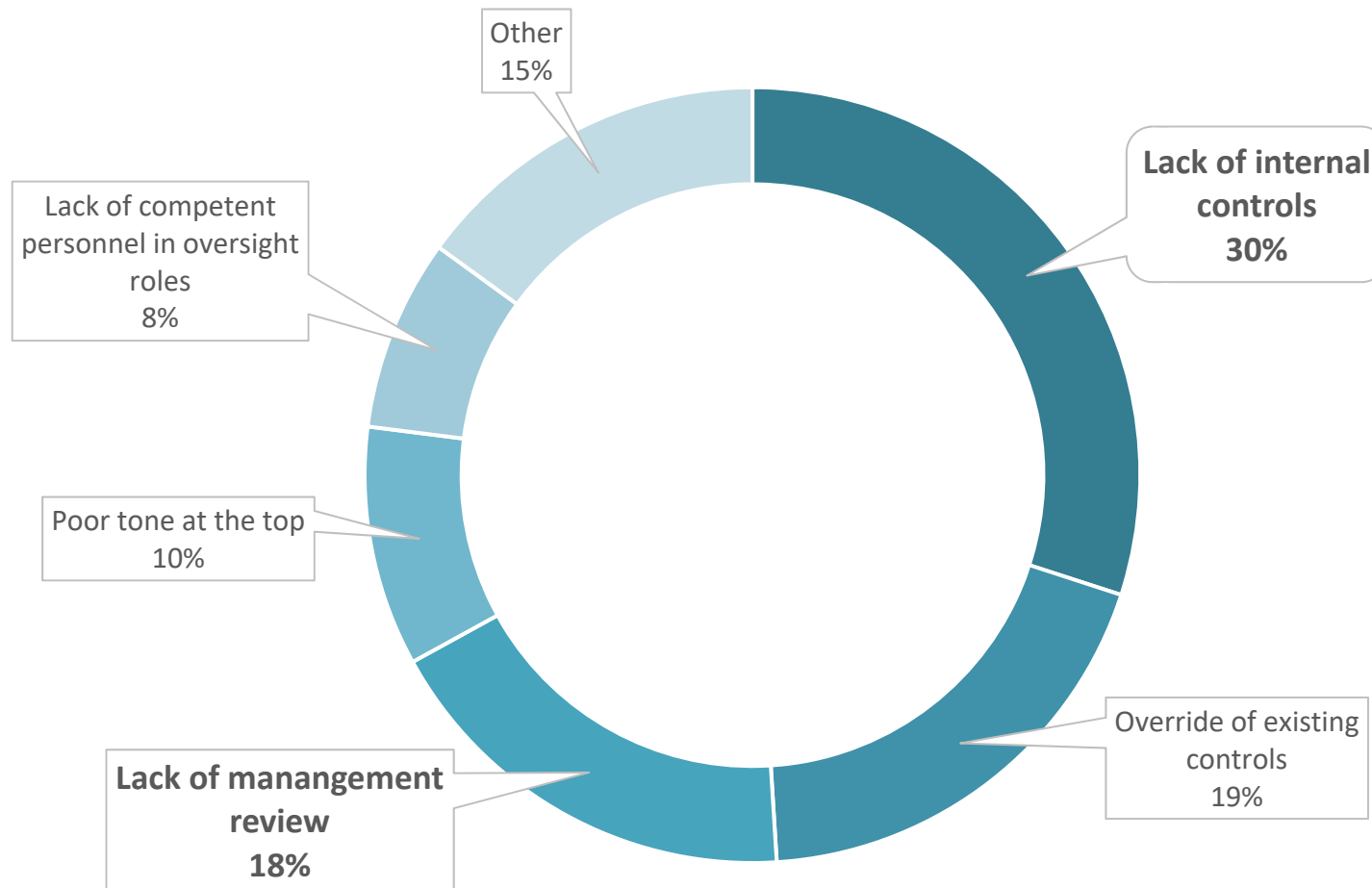
Source: 2018 ACFE Report to the Nations on Occupational Fraud & Abuse - study of 2,690 fraud cases

How is Fraud Detected?



Source: 2018 ACFE Report to the Nations on Occupational Fraud & Abuse - study of 2,690 fraud cases

Control Weaknesses that Contributed to Fraud



Source: 2018 ACFE Report to the Nations on Occupational Fraud & Abuse - study of 2,690 fraud cases

Internal Controls and Efficiency

It's not always about fraud:

- Controls help prevent/detect human error
 - System input errors
- Automation can eliminate risk and increase efficiency
 - Direct time entry eliminating hardcopy timesheets
- Redundant or unnecessary steps
 - Reconciling GPR to SOA

University of Michigan Compliance Hotline

- 1-866-990-0111
<https://compliance.umich.edu/report-a-concern/>
- A website and dedicated phone number available to all faculty and staff as an additional avenue to report potential concerns in three specific areas:
 - Financial Management
 - Regulatory Adherence
 - Patient Safety
- Does not replace existing reporting mechanisms in the Health System or on campus
- Managed by a third-party vendor; allows 24-hour availability and callers may remain anonymous

Internal Control Related Resources



- The Office of Internal Controls website: <http://www.finance.umich.edu/controls>
 - ❑ Provides guidance, support tools, and documents
 - ❑ Helps units across campus manage financial related processes
- Contact The Office of Internal Controls: <http://www.finance.umich.edu/controls/contact>
 - ❑ Brent Haase, Internal Controls Manager: (734)763-0260 or haasebr@umich.edu
 - ❑ Kay Bressler, Internal Controls Data Analyst: (734)763-4359 or bressler@umich.edu
 - ❑ Cory Belote, Internal Controls Coordinator: (734)615-0121 or ctremp@umich.edu
- University Audits website: <http://www.umich.edu/~uaudits/>
- Compliance Resource Center: <https://ogc.umich.edu/compliance-resource-center/>
- Compliance Hotline: <https://compliance.umich.edu/report-a-concern/>



LEARN MORE ABOUT U-M COMPLIANCE »

COMPLIANCE HOTLINE