

Internal Controls Back to Basics

An overview of some key fundamentals

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Internal Controls

“A means to an end”

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

- Effectiveness & Efficiency of Operations
- Compliance with Laws and Regulations
- Reliability of Financial Reporting

Fraud

Intentional deception resulting in unauthorized personal gain

Organizations **lose** an average of **5%** of their **annual revenues** to fraud

Internal Control weaknesses are responsible for nearly 1/3 of frauds

Types of Fraud

Asset Misappropriation

86%
of Fraud
Cases

\$100,000 Median Loss

Financial Statement Fraud

10%
of Fraud
Cases

\$954,000 Median Loss

Who Commits Fraud?

The Fraud Triangle



72% of fraudsters were male

41% of frauds were committed by low-level employees

37% of perpetrators were between the ages 36 - 45

Fraudsters who had been with their company longer stole **twice** as much

85% of fraudsters displayed at least one behavioral red flag
and in
49% of cases they exhibited multiple red flags

6 Behavioral Red Flags of Fraud

1. Living Beyond Means
2. Financial Difficulties
3. Unusually Close Association with Vendor/Customer
4. Control Issues, Unwillingness to Share Duties
5. Irritability, Suspiciousness, or Defensiveness
6. "Wheeler-Dealer" Attitude

U-M Compliance Hotline



It's up to each of us to do the right thing.



LEARN MORE ABOUT COMPLIANCE AT U-M,
ASK QUESTIONS AND REPORT CONCERNS:

COMPLIANCE.UMICH.EDU



Tips are the most common initial detection method



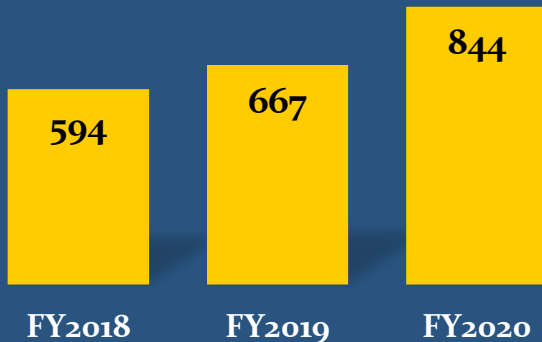
43% of fraud cases were initially detected by tips



Fraud losses were 50% smaller at organizations with hotlines

U-M Compliance Hotline Statistics

The number of reports to the U-M Compliance Hotline has significantly increased over the past 3 years



In FY2020



62% of tips were reported over the internet



38% of tips were reported over the phone



61% of tips were anonymous

Commonly Reported Concerns:

- Financial Mismanagement
- Conflict of Interest
- Data Privacy Issues
- Hostile Work Environment
- Discrimination
- Theft of Services or Time

Standard Practice Guide (SPG)

The official repository for the institution-wide policies of the University of Michigan

Key Aspects of the SPGs

- Define and set a standard for organizational and individual conduct
- Approved by university leadership and apply to the entire institution
- Reviewed and updated every five years

Receive quarterly notifications of new, changed or decommissioned policies by joining the self opt-in email group. See <http://spg.umich.edu/policies/revisions> for more details.

Standard Practice Guide Overview presentation can be found at <http://www.finance.umich.edu/controls/training>

The SPG Website

Contains:

- University policies
- Links to procedures
- Organization charts
- List of recently updated policies
- FAQs
- Contact information to ask questions

spgonline@umich.edu

<https://spg.umich.edu/>

Search bars allow you to:

- search the whole SPG web site
- search within an SPG

SPGs are organized into 5 Categories:

- Human Resources (200s)
- Research (300s)
- Student Affairs (400s)
- Business and Finance (500s)
- General Policies (600s)

There are approximately
180 SPGs

Annual Internal Controls Certification

- Designed to **improve awareness and accountability** related to fiscal stewardship and internal controls
- Leverages **best practices** from Sarbanes-Oxley Act

46 Certifying Units:

- **19 Schools & Colleges**
- **Athletics**
- **Flint**
- **Dearborn**
- **Michigan Medicine**
- **VP Offices**
- **Other Units**

Deans/Directors/Vice Presidents
Sign annual Certification Form to attest that they:

- Meet fiscal & stewardship responsibilities
- Review & understand unit's financial performance & confirm it fairly represents activities
- Are aware of and committed to enforcing appropriate internal controls in unit

Key Unit Certification Elements / Tasks

Review internal controls of financial related processes
- Unit focused - - decentralized environment

Internal Controls Gap Analysis

- Annual review of key unit internal control points
- Validates controls are in place
- Should be completed by individuals involved in process

Written Procedures Documentation

- Clarify roles & responsibilities
- Ensure process is happening as intended
- Help with employee turnover

Management Oversight Reporting

- Identifies key trends / exceptions
- High level summaries (by month, year, etc.)
- Many with drill-down functionality

Dept Sub-Certification (optional)

- Provides support for Dean / Director / VP Certification
- Performed at the department level
- Same questions as Annual Certification

Key Financial Related Training

Employees not completing required training is **one of the most common internal control issues** across U-M. Effective training provides individuals with the **knowledge and skills** necessary to perform the essential duties of their position

<u>What Training?</u>	<u>Who has to take it?</u>	<u>How often?</u>
Concur Approver Training (TEE102)	All Concur Approvers	Once
Concur Expense Approver Refresher Training (TEE103)	All Concur Approvers	Every 3 Years
Depository Certification Training (TME101)	All Individuals Preparing or Allocating Deposited Funds	Every 2 Years
Merchant Certification Course (TME102)	All Individuals Who Come into Contact with Credit Card Data	Annually
Treasury Management–Cash Handling (TME103)	All Individuals Who Handle Cash or Non-Cash Valuables	Once

The Benefits of Documented Procedures

- Clarifies responsibilities and documents expectations
- Improves efficiency and productivity
- Makes it easier to train new employees
- Assures consistent quality and performance

The **Written Procedure Templates** found on the Internal Controls website include:

- **Key control points** from the gap analysis tools
- **Links** to related training, SPGs, websites, etc.
- Units can **customize the templates as appropriate** to reflect unit specific procedures

<http://www.finance.umich.edu/controls/tools>

Five Components of an Effective Internal Controls Environment

The COSO Framework provides a model for evaluating the effectiveness of Internal Controls

In an **effective** internal control system, the following **five components** work to **support** the achievement of an entity's mission, strategies, and related business practices



Control Environment

Represents the culture of Internal Controls at an organization (i.e. a culture of discipline & compliance or a culture of lax policies & procedures - This culture begins with the actions of executive management - "The Tone at the Top")

Risk Assessment

All of the processes and associated risks in an organization are assessed based on level of risk and likelihood of occurrence to determine how they should be addressed

Control Activities

Procedures and internal controls put in place to mitigate identified risks

Information & Communication

How management communicates the culture of compliance & specific policies individuals need to follow

Monitoring Activities

Activities used to monitor processes or internal controls

17 Principles of an Effective Internal Controls Environment

These Principles serve as a **framework for assessing the effectiveness of Internal Controls**
– within the scope of the 5 Components of an Effective Control Environment

Control Environment

1. Commitment to integrity & ethical values
2. Exercises oversight responsibility
3. Establishes structure, reporting lines, authority, & responsibility
4. Attract, develop, & retain competent people
5. People held accountable for internal controls

Risk Assessment

6. Clear objectives specified
7. Identifies & analyzes risk
8. Potential for fraud considered
9. Significant changes identifies & analyzed

Control Activities

10. Control activities selected & developed
11. General IT controls selected & developed
12. Controls deployed through policies & procedures

Information & Communication

13. Quality information obtained, generated, & used
14. Internal controls information communicated internally
15. Internal controls information communicated externally

Monitoring Activities

16. Ongoing and/or separate evaluations conducted
17. Deficiencies Evaluates & communicated

Questions to Consider

- Are all of these elements in place in your unit?
- Which elements does your unit do well and which need improvement?
- Is help needed in your unit to make improvements?

