Internal Controls

Back to Basics

An overview of some key fundamentals
Presentation Topics

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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

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

Nearly HALF of all cases occurred due to:
29% Lack of internal controls or
20% Override of existing controls

Types of Fraud

Asset Misappropriation
86% of Fraud Cases

Financial Statement Fraud
9% of Fraud Cases

$100,000 Median Loss

$593,000 Median Loss

Statistics from Certified Fraud Examiner’s 2022 Global Study on Occupational the Association Fraud and Abuse
Who Commits Fraud?

Fraud Triangle

- Pressure
- Rationalization
- Opportunity

73% of fraudsters were male

6% of perpetrators had a prior fraud conviction

54% of perpetrators were between the ages 31 - 45

Fraudsters who had been with their company longer stole three times as much

85% of fraudsters displayed at least one behavioral red flag and in

51% 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. Bullying or intimidation

Statistics from the Association of Certified Fraud Examiner’s 2022 Global Study on Occupational Fraud and Abuse
COVID Impacts on Fraud

Financial Pressures – Recent Impacts:
• Financial impact (furlough, lack of merits)
• Record inflation levels
• Social Media status pressure

Opportunities – Recent Impacts:
• Change or loss of controls
• Remote work
• Staff shortages, concentration of duties

Rationalization – Recent Impacts:
• Furloughs, pay cuts, lack of merits
• Fear of economic upheaval
• Senior management misconduct
Tips are the most common initial detection method.

42% of fraud cases were initially detected by tips (nearly 3x as many cases are detected by tips as the next most common method).

Fraud losses were 50% smaller at organizations with hotlines. More than HALF of all tips came from employees.
U-M Compliance Hotline Statistics

The number of reports to the U-M Compliance Hotline over the past 4 years

<table>
<thead>
<tr>
<th>Year</th>
<th>Reports</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2019</td>
<td>667</td>
</tr>
<tr>
<td>FY2020</td>
<td>844</td>
</tr>
<tr>
<td>FY2021</td>
<td>891</td>
</tr>
<tr>
<td>FY2022</td>
<td>971</td>
</tr>
</tbody>
</table>

In FY2022

- 63% of tips were reported over the internet
- 26% of tips were reported over the phone
- 62% of tips were anonymous

Commonly Reported Concerns:

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

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

https://spg.umich.edu/
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

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
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.

<table>
<thead>
<tr>
<th>What Training?</th>
<th>Who has to take it</th>
<th>How often?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concur Approver Training (TEE102)</td>
<td>All Concur Approvers</td>
<td>Once</td>
</tr>
<tr>
<td>Concur Expense Approver Refresher Training (TEE103)</td>
<td>All Concur Approvers</td>
<td>Every 3 Years</td>
</tr>
<tr>
<td>Depository Certification Training (TME101)</td>
<td>All Individuals Preparing or Allocating Deposited Funds</td>
<td>Every 2 Years</td>
</tr>
<tr>
<td>Merchant Certification Course (TME102)</td>
<td>All Individuals Who Come into Contact with Credit Card Data</td>
<td>Annually</td>
</tr>
<tr>
<td>Treasury Management–Cash Handling (TME103)</td>
<td>All Individuals Who Handle Cash or Non-Cash Valuables</td>
<td>Once</td>
</tr>
<tr>
<td>PCard Training (PRE110)</td>
<td>All PCard Holders</td>
<td>Every 3 Years</td>
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</table>
The Benefits of Documented Procedures

- Ensures all risks appropriately addressed
- Provides clarity of expectations
- Helps in personnel transition
- Aids in development of process

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](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**
Representing 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

<table>
<thead>
<tr>
<th>Control Environment</th>
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<tbody>
<tr>
<td>1. Commitment to integrity &amp; ethical values</td>
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<tr>
<td>2. Exercises oversight responsibility</td>
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<tr>
<td>3. Establishes structure, reporting lines, authority, &amp; responsibility</td>
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<td>4. Attract, develop, &amp; retain competent people</td>
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<tr>
<td>5. People held accountable for internal controls</td>
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<table>
<thead>
<tr>
<th>Risk Assessment</th>
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<tbody>
<tr>
<td>6. Clear objectives specified</td>
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<tr>
<td>7. Identifies &amp; analyzes risk</td>
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<tr>
<td>8. Potential for fraud considered</td>
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<tr>
<td>9. Significant changes identifies &amp; analyzed</td>
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<table>
<thead>
<tr>
<th>Control Activities</th>
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</thead>
<tbody>
<tr>
<td>10. Control activities selected &amp; developed</td>
</tr>
<tr>
<td>11. General IT controls selected &amp; developed</td>
</tr>
<tr>
<td>12. Controls deployed through policies &amp; procedures</td>
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<table>
<thead>
<tr>
<th>Information &amp; Communication</th>
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<tbody>
<tr>
<td>13. Quality information obtained, generated, &amp; used</td>
</tr>
<tr>
<td>14. Internal controls information communicated internally</td>
</tr>
<tr>
<td>15. Internal controls information communicated externally</td>
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<table>
<thead>
<tr>
<th>Monitoring Activities</th>
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<tbody>
<tr>
<td>16. Ongoing and/or separate evaluations conducted</td>
</tr>
<tr>
<td>17. Deficiencies evaluated &amp; communicated</td>
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</tbody>
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### 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?