

# Internal Controls Back to Basics

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*An overview of some key fundamentals*

# Presentation Topics

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# Internal Controls

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*“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

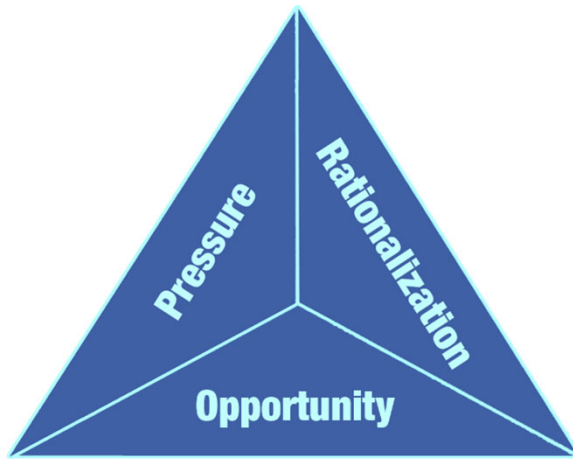
9% of  
Fraud  
Cases

\$100,000 Median Loss

\$593,000 Median Loss

# Who Commits Fraud?

Fraud Triangle



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

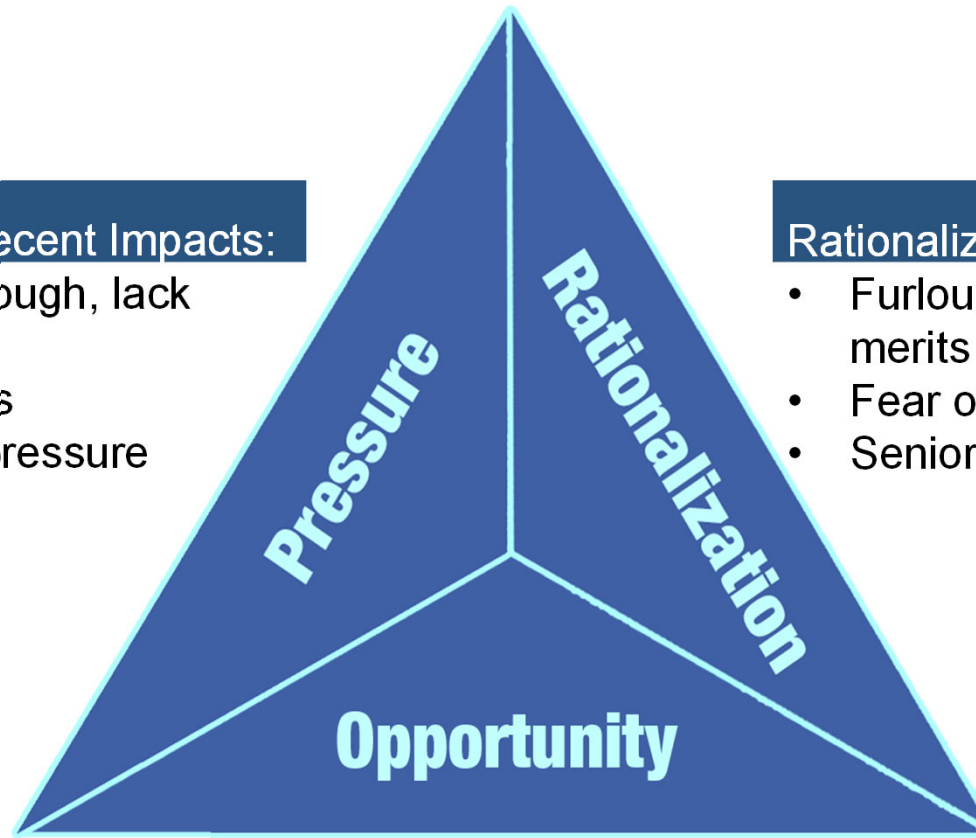
## 6 Behavioral Red Flags of Fraud

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

# COVID Impacts on Fraud

## Financial Pressures – Recent Impacts:

- Financial impact (furlough, lack of merits)
- Record inflation levels
- Social Media status pressure



## Rationalization – Recent Impacts:

- Furloughs, pay cuts, lack of merits
- Fear of economic upheaval
- Senior management misconduct

## Opportunities – Recent Impacts:

- Change or loss of controls
- Remote work
- Staff shortages, concentration of duties

# 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.



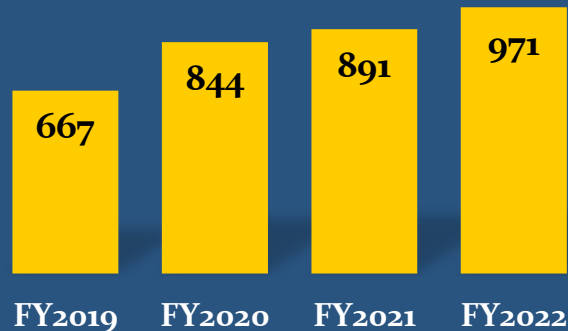
42% of fraud cases were initially detected by tips (nearly 3x as many cases are detected by tips as the next most common method).



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



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

# Standard Practice Guide (SPG)

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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](mailto: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
PCard Training (PRE110)	All PCard Holders	Every 3 Years

# The Benefits of Documented Procedures

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- 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>

# 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 evaluated & 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?

