

Internal Controls

What Are They and Why Should I Care?

or

Isn't That Someone Else's Job?

RCAG

April 19, 2007

Agenda

- ❑ Pre-test
- ❑ Risk
- ❑ Internal Control
- ❑ False Claims & Misappropriations
- ❑ Office of University Audit
- ❑ Q&A

Pre-test: Internal Controls

- 1) Internal controls *start* with a strong:
 - a) Set of policies and procedures
 - b) Internal environment
 - c) Compliance department

Pre-test: Internal Controls

2) The primary owner of internal controls is:

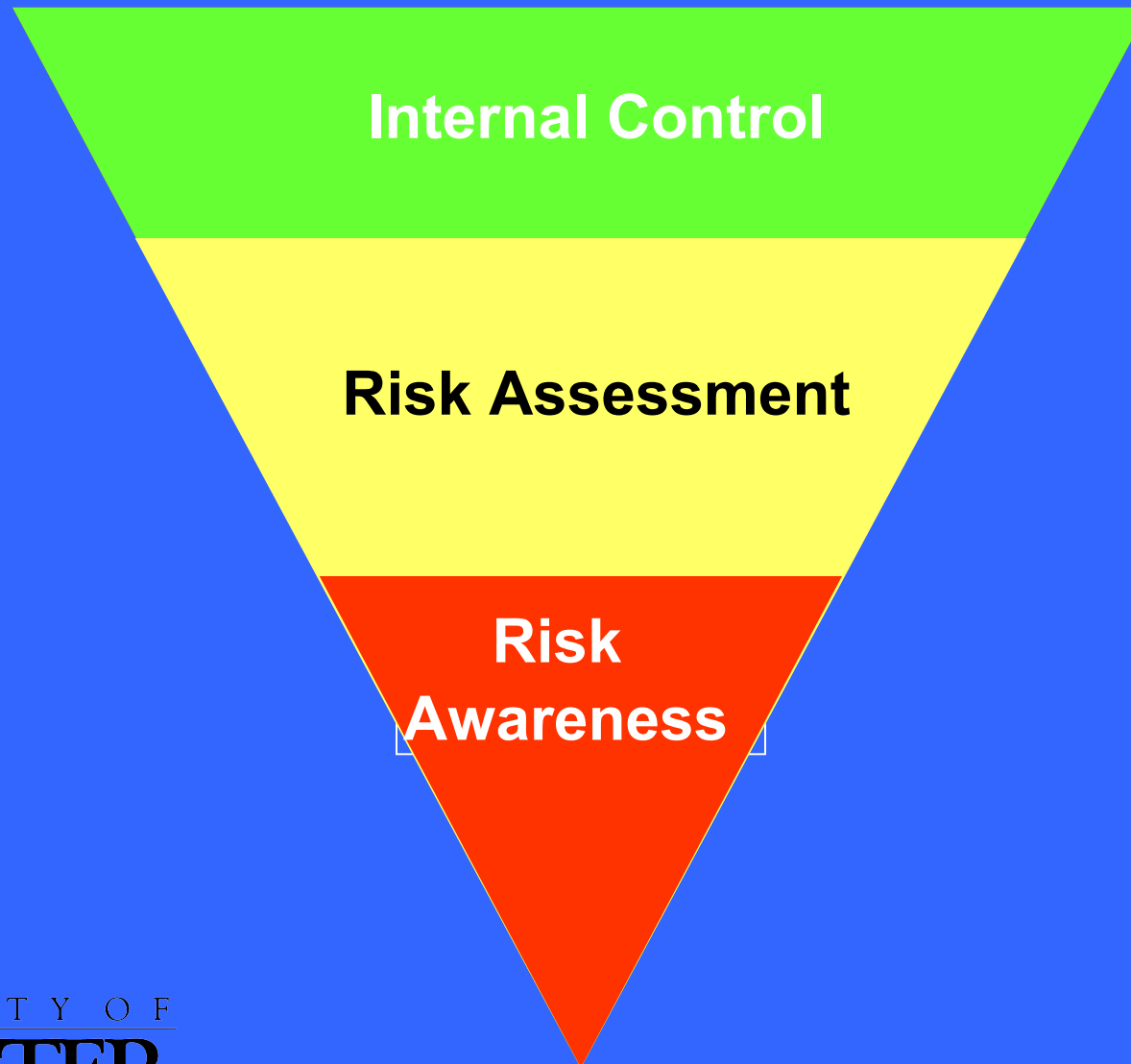
- x Management
- x Compliance Office
- x Internal Audit

Pre-test: Internal Controls

- 3) Strong internal controls assist the **River Campus's** success as they:
- x Assure ***no*** fraud or financial inaccuracies will occur
 - x Will detect ***all*** fraud or financial inaccuracies
 - x Provide ***reasonable assurance*** that fraud or financial inaccuracies will be prevented or detected in a timely manner

Risk

Setting the Stage.....



What are Risks?

A **RISK** is **ANYTHING** that could jeopardize the achievement of your organization's objectives. **RISKS** are assessed within five key categories:

- ❖ **Strategic**
 - ❖ *Joint ventures*
- ❖ **Financial**
 - ❖ *Cash operations*
- ❖ **Operational**
 - ❖ *Capacity*
- ❖ **Regulatory**
 - ❖ *OSHA / HIPAA*
- ❖ **Reputational**
 - ❖ *Quality of Care*

How are Risks Identified?

For each work objective, ask yourself:

- ❖ What could go wrong?
- ❖ What do you worry about? (*work-wise!*)
- ❖ What assets need to be protected (both physical and intellectual)?
- ❖ How could someone take advantage of us (directly or indirectly)?
- ❖ What activities are regulated by the state and federal governments?
- ❖ What are the greatest legal exposures?
- ❖ What life safety issues do we face? Hazardous conditions?

How are Risks Assessed?

- ❑ **Likelihood** – Probability of Occurrence (High / Medium / Low)
- ❑ **Impact** – Effect on the **River Campus** (H / M / L) in terms of:
 - ❖ **Loss of resources**
 - ❖ *Decreased research funding*
 - ❖ **Loss of public trust**
 - ❖ *Declining enrollment*
 - ❖ **Bad publicity**
 - ❖ *Difficult to attract highly skilled faculty, staff & students*
 - ❖ **Unsafe environment for students and employees**
 - ❖ *Increase in worker's comp claims and Litigation*

How are Risks Managed?

- ❑ Risks can be effectively managed through:
 - ❖ Avoidance
 - ❖ Transfer
 - ❖ Acceptance
 - ❖ Sharing (e.g., Insurance)
 - ❖ Mitigation and reduction with cost-effective Internal Controls

PLEASE NOTE:

**IGNORING RISK IS NOT AN EFFECTIVE RISK
MANAGEMENT TACTIC**

Internal Control

What is Internal Control?

“**Internal Control** is a process, effected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance of the achievement of objectives in the following categories:

- ❖ Effectiveness and efficiency of operations
- ❖ Reliability of financial reporting
- ❖ Compliance with applicable laws and regulations”

Source: Committee of Sponsoring Organizations of the Treadway Commission, Internal Control – Integrated Framework

Why do We Need Internal Controls?

Properly designed and implemented **Internal Controls** will mitigate the risks (reduce the probability and impact) and will assist in:

- ❖ Safeguarding of assets
- ❖ Ensuring all transactions are recorded, and all recorded transactions are real
- ❖ Protecting the **River Campus** from litigation or loss of grants, gifts, or donations

Key Concepts

- ❑ Internal control is:
 - ❑ A **PROCESS**
 - ❑ Effected by **PEOPLE**
 - ❑ That provides **REASONABLE ASSURANCE** and
 - ❑ **REQUIRES APPROPRIATE BALANCE** between risk appetite and level of control, where
 - ❑ Operational **COST** of the controls do not exceed the **BENEFIT**

INTERNAL CONTROL IS EVERYONE'S RESPONSIBILITY!

It's a Balance.....



Excessive Risks

- Loss of Income
- Theft of Assets
- Poor Decisions
- Non-Compliance
- Public Scandals

Excessive Control

- Increased Costs
- Reduced Productivity
- Increased Complexity
- Increased Cycle Time
- Decreased Motivation

What Can Happen in the Absence of Strong Internal Controls?

- ❑ Research funds could be misspent
- ❑ Employees could be:
 - ❑ over / under paid for their work, or
 - ❑ reimbursed for expenses that they did not incur
- ❑ Computers and data they contain could be stolen
- ❑ Hackers could gain access to confidential / protected information
- ❑ Equipment could experience critical failures that could result in physical harm

.....THE LIST IS ENDLESS!

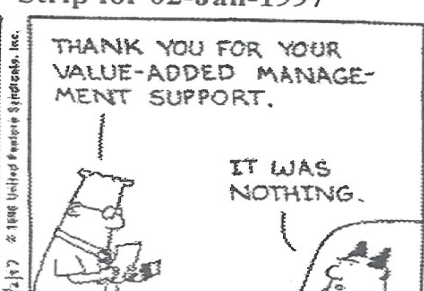
So, Why Should I Care?

Strong Internal Controls also **PROTECT** you, other employees, our students and the River Campus.



The Dilbert Archive!

Strip for 02-Jan-1997



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A Strong Internal Environment

The tone at the top of an organization influences the control consciousness of its people. A strong ***INTERNAL ENVIRONMENT*** is supported by Management who:

- ❖ Promote Ethical Values and Conduct
- ❖ Lead by Example
- ❖ Are Approachable
- ❖ Comply with Policies (Do as I do)
- ❖ Recognize People Who are Doing Things Right

REMEMBER,

THINGS THAT ARE MONITORED GET DONE!

Control Activities

CONTROL ACTIVITIES -

These are the *Policies and Procedures* that help ensure the necessary actions are taken to address risks related to the achievement of the organization's objectives.

Policies exist in all organizations. Some are University-wide, such as HR and Finance while others are **River Campus** - or department - specific.

Internal Control Characteristics / Activities

Internal Controls can be Preventive or Detective:

Preventive:

- ❖ Provides **reasonable assurance** that problems will be prevented
 - Authorization / Approvals
 - Segregation of duties
 - Management oversight
 - System access controls (passwords)
 - Physical access controls
 - Cash safes
 - Safety clothing

Detective:

- ❖ Provides **reasonable assurance** that problems will be detected
 - Account reconciliation and review
 - Budget vs actual analyses
 - Exception reports
 - Complaints / tips / hot-line calls
 - Job rotations
 - Mandatory vacations

Preventive controls are more effective than detective controls.

“An ounce of prevention is worth a pound of cure”

Internal Control Characteristics / Activities

Internal Controls can be Automated or Manual:

Automated:

- Three way match before payment (PO, Invoice, proof of receipt)
- Batch control totals
- Electronic signatures
- Background and credit checks and approvals
- Card swipe for time-keeping
- HRMS

Manual:

- Manual reconciliations
- Authorized signatures
- Information verification
- Employee appraisals
- Standardized hard copy forms
- FRS

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Automated controls are supported by computer systems.

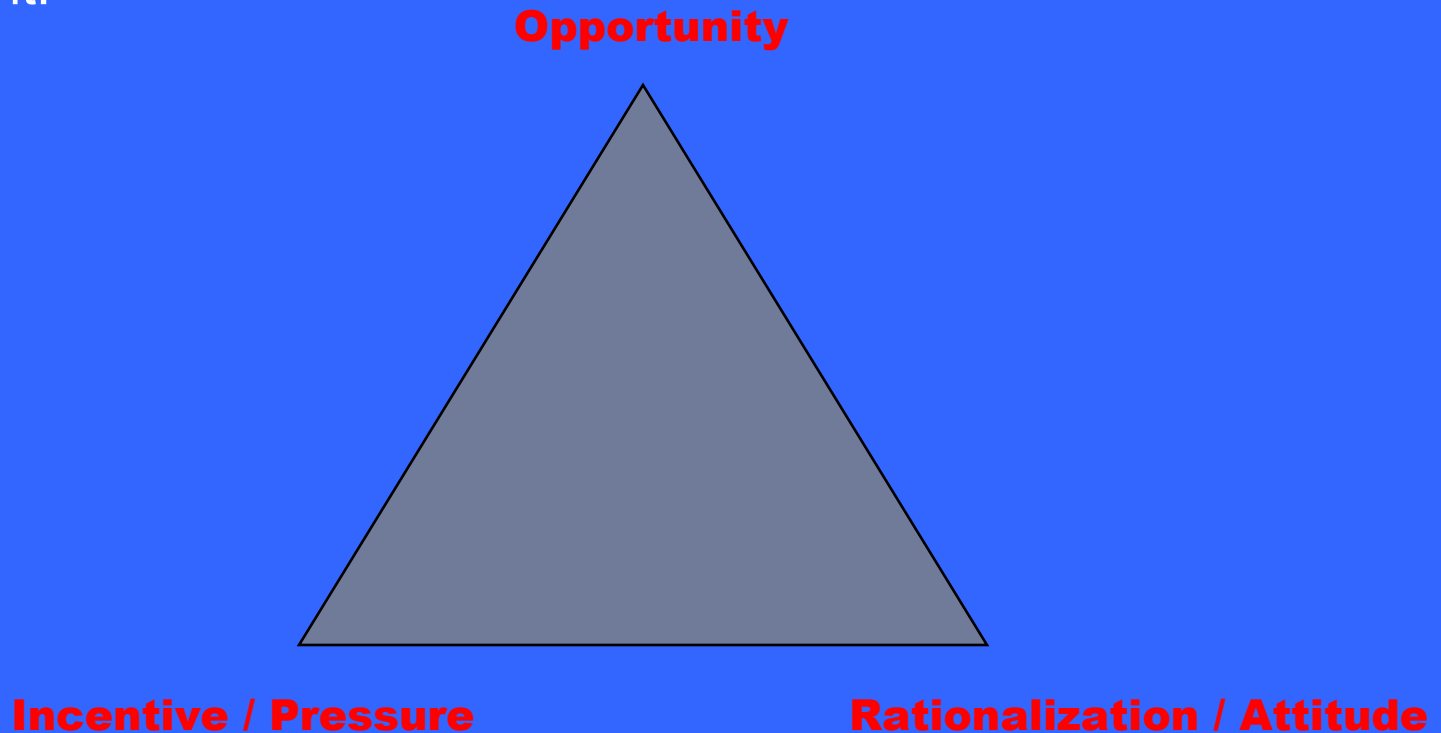


To ensure that computer systems continue to work properly, general IT controls must be in place.

False Claims & Misappropriations

Fraud Triangle

The Fraud Triangle depicts the three conditions that foster a fraudulent environment:



Fraud is difficult to detect and generally cannot be completely prevented. The key to mitigating risk of fraud is to significantly reduce **OPPORTUNITY**.

Recent Headlines:

Falsification of Records and Misappropriation

Former Coach Indicted on Fraud Charges for Providing Phony Academic Credits to Basketball Players

A federal grand jury in Kansas indicted a former college-basketball coach last month on charges that he **arranged for his players to receive phony academic credit** and **stole \$120,000 in Pell Grants and other funds** the players were supposed to have received.

(A)ccording to the indictment, **(he) arranged for athletes to obtain credit for courses they had not taken**. In one case, he **arranged for another student to take a general-equivalency-diploma examination for an athlete**. The fake credentials made the players eligible for federal grants, work-study jobs, and eventually admission to four-year institutions.

(He) also **provided falsified transcripts...to keep players eligible** the indictment says.

"The crimes of which (he) is accused represent not only a transgression against the federal government, which provides student assistance funds, but a wrong done to student-athletes who deserve to receive a quality education," said the U.S. attorney for the district of Kansas,

(He) faces a total of 51 years in prison and over \$1.5-million in fines if found guilty of all counts.

<http://chronicle.com> Section: Athletics Volume 51, Issue 18, Page A44

Recent Headlines: Student Loan Kickbacks

THE ASSOCIATED PRESS, April 11, 2007

Cozy arrangements between colleges and the companies that lend their students billions of dollars are far more widespread than anticipated, (New York) State **Attorney General Andrew Cuomo** told The Associated Press yesterday, even as another college financial aid officer was suspended amid a probe into the **\$85 billion industry**.

Cuomo...said the **investigation could lead to criminal charges** against high-ranking officials at lending companies and universities.

It's more widespread than we originally thought. . . . More schools and more lenders at the top end. "We have demonstrated **this is not just the exception. This is the rule.**"

Cuomo is investigating **alleged kickbacks to school officials who steered students to certain lenders**. His investigators say they have found numerous arrangements that benefited schools, financial aid officers and lenders at the expense of students.

Investigators found that many colleges have established **"preferred lender" lists** and entered into **revenue sharing** and other financial arrangements with those lenders. Some colleges have **"exclusive" preferred lender agreements** with the companies.

So far, **six schools**, including the University of Pennsylvania and New York University, have agreed to **reimburse students** a total of **\$3.27 million...**

<http://www.newsday.com/business/ny-bzloan5166318apr11,0,3352538.story?coll=ny-business-print>

Accountability and Trust

You can delegate ***DUTIES***, but

You cannot delegate ***ACCOUNTABILITY***

Trust but ***VERIFY!***

MISSION STATEMENT

“Our mission is to provide audit and advisory services to the University Community by assessing risks, analyzing controls, and ensuring that business practices are effective, efficient, and compliant with University and regulatory policies.”

Office of University Audit

- ❑ An annual University-wide risk assessment is conducted by the Office of University Audit to identify critical areas and develop the annual audit plan.
- ❑ Risk assessment is an integral component of all OUA audit services.
- ❑ Additional resources include:

www.rochester.edu/adminfinance/audit
University Integrity Hotline (585-756-8888)

www.theiia.org

www.isaca.org

Thank You for Your Attention!

Questions?

Internal Control - Detail

How Can Internal Control Be *Compromised*?

Segregation of Duties

- Explanation of
- Examples

Source: Office of University Audit

How Can Internal Controls Be Compromised?

Ignorance of University Policies / Government Regulations

- “I didn’t know...”

Inadequate Segregation of Duties

- We give more responsibilities to those we trust; *“only people we trust can steal from us as we keep a close watch over those we don’t trust”*

Unrestricted Access to Assets

- Shared passwords, unlocked offices, unsecured cash

Form over Substance

- Approving documents without proper review

Control Override

- “This way is a lot quicker”

INHERENT LIMITATIONS –
IMPOSSIBLE TO ELIMINATE ALL RISK

Internal Controls – Segregation of Duties

Ideally, an individual should not perform more than one of the following activities:

- Authorization
- Custody
- Record Keeping and
- Reconciliation

If limited staff precludes adequate segregation of duties a *mitigating control*, such as management review, should be in place.

Segregation of Duties - Examples

Duty / Area	Billing	Purchasing	Payroll
Authorization Review / Approve (transactions or operations)	Verify cash & daily balancing reports	Approve Purchase Requisitions or Purchase Orders	Approve time sheets, payroll, leave requests
Custody Access to Assets (cash, checks, equipment, supplies, materials)	Access to funds, safes	Receives goods or services; Maintains inventories	Handling or distributing Paychecks
Recording Create & Maintain Records	Entering charges, posting payments to an A/R system	Maintaining inventory records	Preparing Payroll Certifications and leave
Reconciling Compare	Billing documents to billing summaries; Funds collected to A/R postings; Collections to deposits; Surprise counts	Perform physical inventory counts; Compare inventory changes to amounts purchased and sold	Compare payroll certifications to payroll summaries