Internal Controls & Ethics
Session Objectives

- Refresher on Internal Audit
- Be able to assess risks in your department
- Be able to apply internal control concepts to mitigate risks and accomplish your objectives
- Clearly understand ethical values and conduct expected of MSU staff
“To assist University units in effectively discharging their duties while ensuring proper control over University assets.”
Internal Audit Charter

• Establishes our purpose, authority, and scope
• Identifies the importance of independence
• Provides for full access to records
• Prohibits making operational decisions
Internal Audit Engagement Types

- Limited review
- Audits: Compliance, Financial, Operational
- Fraud Investigation
- Consulting Assignment
- Audits: Information Technology
- Other Special Investigations or Projects
- Leadership Change Review
Common Audit Areas

• Understanding internal controls
  • Segregation of duties; reviews; reconciliations

• Testing significant activity including:
  • Cash receipts/Accounts receivable
  • Expenditures (including payroll, travel, endowments/scholarships)
  • Procurement cards
  • Grant activity including effort reporting
  • Equipment inventory
  • Resale inventory

• Significant contracts

• Sensitive data

• Conflict of Interest/Outside work for pay
“C.I.A.” Core Control Concept

• **Confidentiality**
  - Keeping sensitive data a secret from those without a need-to-know.
  - Opposing Force: *Disclosure* (Fines, Legal Action, Loss of Public Trust)

• **Integrity**
  - Protecting data against unauthorized modifications.
  - Opposing Force: *Alteration* (Inaccurate Info, Financial Loss, Waste of Resources)

• **Availability**
  - Ensuring data is readily accessible by authorized users.
  - Opposing Force: *Destruction* (Waste of Resources, Financial Loss)

*The C.I.A. Triad*
IT Audit Sensitive Data Focus

- Identified as a key risk to the University.
  - *Examples:* SSN, Payment Card Data, Student Info., Medical Records, etc.
  - *Liabilities of Disclosure:* Financial Loss, Legal Action, Loss of Public Trust, etc.

- **MSU Institutional Data Policy (IDP)**
  - Took effect on January 1\textsuperscript{st}, 2011.
  - Defines minimum requirements for securing University institutional data.
  - Applies to all University business and academic units and all MSU employees.
  - Visit the *MSU Enterprise Information Stewardship* webpage for more information.
    - [www.eis.msu.edu](http://www.eis.msu.edu)
Audit Process

Typical Stages of an Internal Audit Review

1. Planning
   - Auditee Engagement
   - Inquiries of Management & Staff
   - Risk Assessment
   - Audit Scope Determination

2. Fieldwork & Documentation
   - Observations of Processes & Procedures
   - Sampling & Testing
   - Verification of Statement Made

3. Issue Discovery & Validation
   - Risk Exposure Discovery & Evaluation
   - Risk Exposure Presentation to Management
   - Management Solution Development

4. Reporting
   - Draft Report Development & Distribution
   - Management Response Opportunity
   - Final Report Distribution

5. Issue Tracking
   - Post Audit Review & Follow Up
   - Periodic Status Updates
How do we decide on the Audit Plan?

- Risk Based
  - Complexity of unit/process
  - Emerging issues or event occurrence
  - Processes and units to validate significant internal controls

Annual Audit Plan

Not limited to Financial type Audits

Specific requests
Representative Risks

- Noncompliance with government and private funding requirements (grant, research)
- Conflict of Interest/commitment
- Financial controls breakdowns
- Reputation damage
- Athletic programs compliance
- State and federal budget constraints (budget & position cuts)
Representative Risks

- Information technology unauthorized access and use
- Environmental, health and safety issues
- Animal and human subjects research
- Disaster recovery/business continuity
- Privacy regulation compliance; HIPAA, FERPA, GLBA, etc.
- Medical compliance
Risk Assessment is an ongoing process

- Identify
- Manage
- Assess

[Diagram showing the cycle: Identify → Manage → Assess → Identify]
How do you identify risks?

• Know your risks.
• For each objective, ask yourself:
  – What could go wrong?
  – What assets do we need to protect?
  – How could someone steal from us?
  – What is our greatest legal exposure?
  – What else?
Assess Risks

- **Likelihood** – probability of occurrence
- **Impact** – effect on MSU/your unit
  - Loss of resources
  - Loss of public trust
  - Violation of policies, laws, regulations
  - Bad publicity
  - Decreased enrollment
  - What else?
Manage Risks

• Transfer – Insure or Contract Away
• Retain – Self-Insure
• Control – Prevention/Reduction
• Avoid – Don’t do it
Question

What are the three major RISKS facing:

• Your college
• Your department
• The University
Internal Controls

Internal Controls
Fraud: Statistics, Indicators, and Prevention
# Figure 1: Geographical Location of Victim Organizations

<table>
<thead>
<tr>
<th>Region</th>
<th>Number of Cases</th>
<th>Percent of Cases</th>
<th>Median Loss (in U.S. dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>646</td>
<td>48.0%</td>
<td>$100,000</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>173</td>
<td>12.8%</td>
<td>$120,000</td>
</tr>
<tr>
<td>Asia-Pacific</td>
<td>129</td>
<td>9.6%</td>
<td>$240,000</td>
</tr>
<tr>
<td>Western Europe</td>
<td>98</td>
<td>7.3%</td>
<td>$200,000</td>
</tr>
<tr>
<td>Eastern Europe and Western/Central Asia</td>
<td>78</td>
<td>5.8%</td>
<td>$383,000</td>
</tr>
<tr>
<td>Canada</td>
<td>58</td>
<td>4.3%</td>
<td>$250,000</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>57</td>
<td>4.2%</td>
<td>$200,000</td>
</tr>
<tr>
<td>Southern Asia</td>
<td>55</td>
<td>4.1%</td>
<td>$56,000</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>53</td>
<td>3.9%</td>
<td>$248,000</td>
</tr>
</tbody>
</table>
Figure 39: Primary Internal Control Weakness Observed by CFE

- Lack of Internal Controls: 32.2% (2014), 39.5% (2012), 37.8% (2010)
- Override of Existing Internal Controls: 10.9% (2014), 10.8% (2012), 11.2% (2010)
- Poor Tone at the Top: 0.4% (2014), 0.4% (2012), 0.4% (2010)
- Other*: 12.2% (2014), 9.8% (2012), 8.8% (2010)
- Lack of Independent Checks/Audits: 3.5% (2014), 2.2% (2012), 1.8% (2010)
- Lack of Employee Fraud Education: 1.9% (2014), 1.6% (2012), 1.6% (2010)
- Lack of Clear Lines of Authority: 1.5% (2014), 1.8% (2012), 1.8% (2010)

*Lack of Reporting Mechanism: 0.7% (2014), 0.6% (2012), 0.6% (2010)

*Other category was not included in the 2010 Report.
Figure 71: Behavioral Red Flags Displayed by Perpetrators

- Living Beyond Means: 43.8%
- Financial Difficulties: 32.0%
- Unusually Close Association with Vendor/Customer: 21.8%
- Control Issues, Unwillingness to Share Duties: 21.1%
- “Wheeler-Dealer” Attitude: 18.4%
- Divorce/Family Problems: 16.8%
- Irritability, Suspiciousness or Defensiveness: 15.6%
- Addiction Problems: 11.6%
- Complained About Inadequate Pay: 8.4%
- Past Employment-Related Problems: 6.9%
- Refusal to Take vacations: 8.1%
- Excessive Pressure from Within Organization: 8.1%
- Social Isolation: 7.4%
- Complained About Lack of Authority: 6.5%
- Excessive Family/Peer Pressure for Success: 6.0%
- Instability in Life Circumstances: 5.9%
- Past Legal Problems: 5.8%
Fraud Indicators

Incentives / Pressures

Opportunities

Attitudes / Rationalization

The Fraud Triangle
Control Environment

TONE AT THE TOP

– Integrity, ethical values, and behavior of management
– Management’s control consciousness
– Management’s commitment to competence

It’s the way you do Business

– Organization structure
– Assignment of authority and responsibility
– Policies and procedures
  • Manual of Business Procedures
Control Activities

The policies and procedures that help ensure that actions identified as necessary to manage risks are carried out properly and in a timely manner

- Must be implemented thoughtfully, conscientiously, and consistently
- Unusual conditions identified must be investigated and appropriate corrective action taken
- Should be proactive, value added, and cost effective
Control Activities

• Approvals, authorizations, and verifications
• Adequate documents and records – original receipts scanned
• Reconciliations
• Reviews of performance
• Security of assets
• Segregation of functions
• Controls over information systems
  • Physical safeguards – restricted access
One HR employee is in charge of hiring, and a second HR employee is in charge of entering and approving time (unit time administrator). Is this a good example of segregation of duties?

1. Yes, because both employees are involved in the HR process.
2. Yes, because HR functions have minimal fraud risks.
3. No, because the second employee in charge of entering time also approves time entered.
4. No, because in order to have proper segregation of duties, someone outside of HR must approve the reports.
An employee has the authority to initiate expenditures, and the Fiscal Officer (FO) of the department approves the transactions and is also the only one to review the monthly operating activity. What controls could be added to reduce the likelihood of fraud?

1. Management (not FO) performs a periodic review of expenditures and selects 3 to 5 to test.
2. Have another person within management use BI or Kuali to run queries on FO activity.
3. Require that the FO report to executive management on all monthly activity.
4. None - one employee initiates and the FO approves
5. 1, 2, and 3
Query Reports

• Financial System query for fiscal officer activity
• Account Review Report (FIN500)
• Monthly Operating Statement (FIN49)
• Budget to actual comparison – not perfect, but can have some benefits
• What other tools have you used?
Key Points

- Supervision – support fiscal officer – be involved
- Assignment of roles – review annually
- Conflict of interest – employment/vendor/time commitment
- Good internal controls – common sense
  - segregation of duties
  - approvals
  - reconciliations – pcards/general ledger/review transactions monthly
  - travel requirements/authorizations (section 70 Manual of Business Procedures
    http://www.ctlr.msu.edu/combp/mbp70EBS.aspx)
  - Personal service contracts
    http://usd.msu.edu/purchasing/purchase-orders/professional-services-contract.html
- Ethical decisions
- Maintain adequate documentation – scanned copies
- Compensation time – policy/documentation
- Address performance issues timely
Methods of Reporting Misconduct

- **MSU Misconduct Hotline**
  - Call Center or Web reporting (outsourced)
  - Concerns reported include:
    - Conflict of Interest
    - Fiscal
    - Medical/HIPAA
    - Privacy
    - Research
    - Safety
    - Any Other Compliance Issue

- **Direct contact with Internal Audit/MSU PD/HR**

- **Key links:**
  - IA website: [www.msu.edu/unit/intaudit/](http://www.msu.edu/unit/intaudit/)
  - Misconduct guidelines: [http://misconduct.msu.edu/](http://misconduct.msu.edu/)
IT'S YOUR CALL

If you have a concern about misconduct, don't keep it to yourself. Discuss it with a supervisor, or contact the misconduct hotline online or by phone. Anonymous reports can be made 24 hours a day, seven days a week.

Report misconduct related to:
- Athletics
- Conflicts of interest
- Discrimination/harassment
- Employment
- Fiscal
Or any other compliance issues that do not fit into these categories

The Misconduct Hotline is not for reporting emergencies. If you need immediate assistance, please dial 9-1-1.

Misconduct Hotline
1-800-763-0764
misconduct.msu.edu

*Misconduct types are provided at misconduct.msu.edu
*The MSU Misconduct Hotline is a tool for the MSU community and others to raise concerns regarding misconduct. The university contracts with a private company, The Network, Inc., to provide this reporting service.
Misconduct Hotline

If you have a concern about misconduct, don’t keep it to yourself. Discuss it with a supervisor or contact the Misconduct Hotline.

Welcome to Michigan State University’s Misconduct Hotline

Michigan State University has implemented a telephone and web reporting Hotline to help maintain adherence to ethical practices. The purpose of the Hotline is to provide an anonymous method to report known or suspected misconduct for Michigan State University related to fiscal matters, conflicts of interest, employment, medical/HIPAA, research, safety, athletics, discrimination/harassment, privacy, retaliation, or any other area of legal, policy, or ethical concern not specifically listed.

The expanded Misconduct Hotline does not replace the University Reporting Protocols regarding child abuse, sexual assault or child pornography. While such issues may be referred to the Misconduct Hotline, employees are also required to follow the reporting protocols. The reporting protocols are available at the Human Resources website (http://www.hr.msu.edu/documents/uwidepolproco/ReportingProtocols.htm).

The University prohibits retaliation against any employee who makes a report in good faith of known or suspected misconduct.

Areas to Report

You can report misconduct in the areas listed below or any other compliance issues that do not fit into an existing area.

- Athletics
- Conflicts of Interest
- Discrimination and Harassment
- Employment
Ethics
What is the Right Thing to do?

Ask yourself three relatively simple questions:

• Is it legal and in compliance with MSU policy?
• Is it fair, honest, responsible, and respectful of individuals?
• Would it pass the newspaper test or the mom test?

If the answer to all three questions is yes, you’re probably OK.
• Do you feel your unit has an ethical tone at the top?

1. Yes
2. No
An ethical dilemma means you’re not sure what the right thing to do is in a given situation

Let’s look at a few situations…
Ethical Dilemma #1

A company that does a lot of business with your unit/department offers you a part-time job working on the weekends.

What would you do?

1. Take it, it’s a lot of $’s for a few hours work, and you have kids’ college tuition to pay.
2. Refuse it, it could put you in a conflict of interest position
3. Discuss it with your supervisor and HR before you decide
Ethical Dilemma #2

The company that does all of your department's shredding sends you a $100 gift certificate for being such a good customer.

What would you do?

1. Take it, it’s only a small token and that’s the way businesses do things
2. Send it back, explaining that University personnel aren’t allowed to accept gifts
3. Share it with others in the department by taking them all out to lunch
A consulting firm that your department has engaged services with in the past sends a fruit basket to you at the office during the Holidays.

What would you do?

1. Take it, it’s only a small token and that’s the way businesses do things
2. Send it back, explaining that university personnel aren’t allowed to accept gifts
3. Share it with others in the department
Ethical Dilemma #4

You are made aware that someone in your organization has a “side” business selling cosmetic products. This person is soliciting orders, delivering products, and collecting money from other department and university personnel during normal working hours.

What would you do?

1. Ignore it. She’s the Dean’s admin, and besides this type of thing happens everywhere

2. Let the Dean know about the situation, explaining that you feel this is a “conflict of commitment” issue in violation of policy

3. Report it on the misconduct hotline
Ethical Dilemma #5

You witnessed a high ranking University employee breaking a University policy but their behavior was not illegal. You know that if you report this violation it will bring negative publicity to the University.

What would you do?

1. Nothing. This doesn’t appear to be an issue
2. Call the Hotline
3. Consult with appropriate University personnel to determine whether there is an issue
Ethical Conduct
Who should you Contact?

• Supervisor
• Human Resources
• Purchasing
• Accounting
• Internal Audit/Misconduct Hotline
• University Legal Counsel
• MSU Police
Session Summary

- Internal Audit overview
- Risk assessment process
- Applying internal control concepts to mitigate risks and accomplish your objectives
- Ethical values
Thank You!

Marilyn K. Tarrant
Executive Director
Email: marilynt@msu.edu

Internal Audit Main Phone: (517) 355-5030
MSU Misconduct Hotline: 1-800-763-0764

Please Visit Our Website For More Information:
www.msu.edu/unit/intaudit