

Internal Control Concepts and Applications for Business Operations at the University of Illinois

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What is Internal Control?

- A process within an organization designed to provide reasonable assurance:
 - That information is reliable, accurate and timely
 - Of compliance with policies, plans, procedures, laws, regulations, and contracts.
 - That assets (including people) are safeguarded.
 - Of the most economical and efficient use of resources.
 - That overall established objectives and goals are met.
- Intended to prevent errors or irregularities, identify problems and ensure that corrective action is taken.

Internal Controls May Be:

- **Preventive** – stops something from happening
- **Detective** – finds out what happened, alerts you as it happens or shortly after
- **Corrective** – follow detective controls, recovery from consequences of an error or unexpected event
- **Directive** – tells folks what should happen

Preventive Controls

- Security Access
- Segregation of duties
- Physical controls over assets
- Authorized signers
- University payables review and approval of travel vouchers prior to processing
- Reminders of policies, procedures, and expectations

Detective Controls

- Banner account reconciliations
- Management review of reconciliations
- Physical inventories
- P-Card logging, reconciliation, and approval
- Review of budget to actual
- Year to year expenditure trending
- Internal auditors

Corrective Controls

- Error communication and reporting
- Documentation systems or processes
- Improvement initiatives
- Discipline actions

Directive Controls

- University of Illinois Statutes
- OBFS policies and procedures
- Campus Administrative Manual
- College policies
- Unit procedures

Who's Responsible???

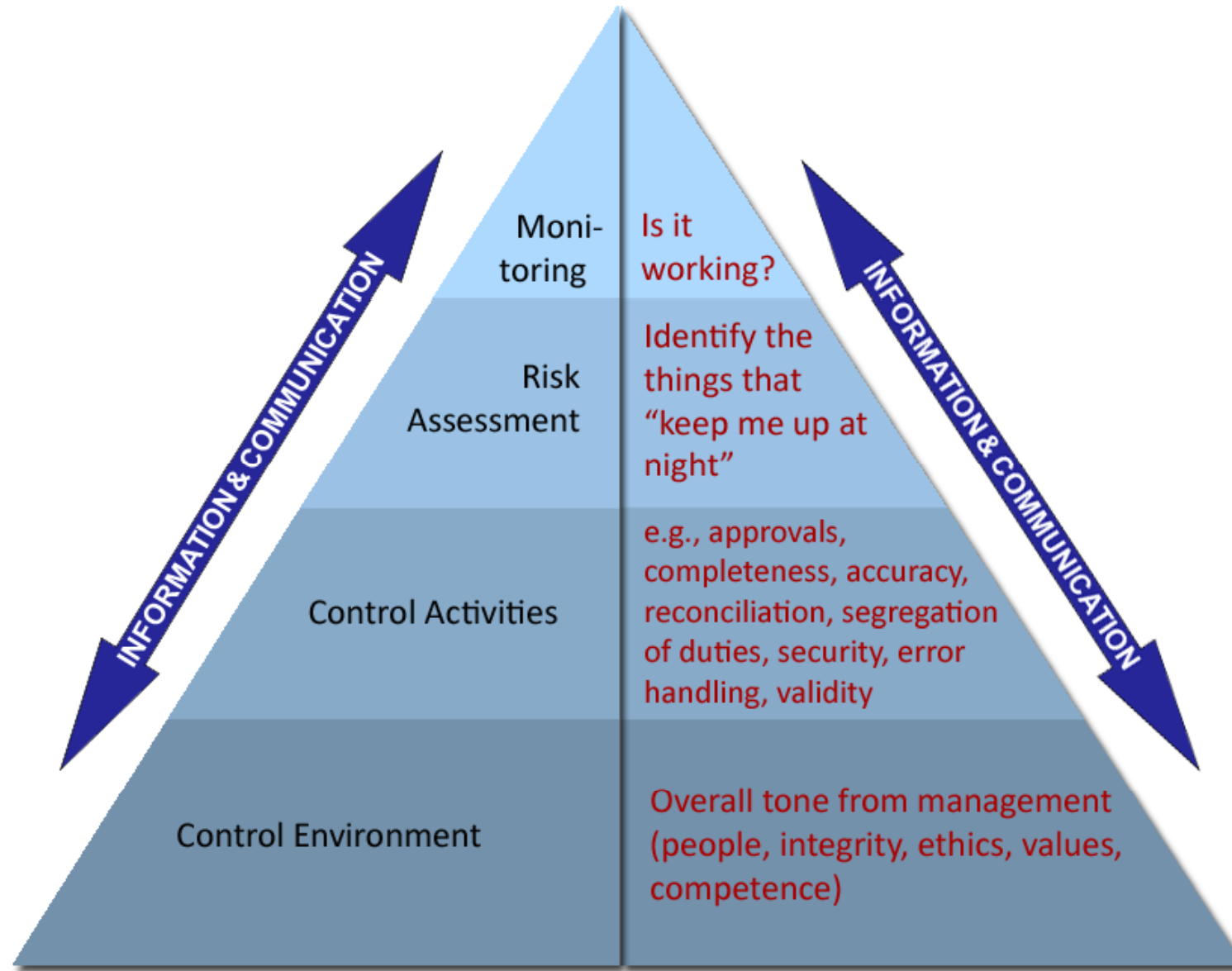
- Board of Directors
- President
- Line management
- Frontline Personnel
- Internal Audit



University Policy establishes some responsibilities for the internal control system to all University employees.

"Internal control gets us where we want to go, without surprises along the way. Internal control is everyone's responsibility...Internal control is me."

- From a Cargill Corporation presentation



What is the “Control Environment” ?

- Personal and professional integrity and ethical values of management and staff
- Established at all levels of an organization
- Official communication on compliance and individual responsibility
- Management’s actions related to gathering facts and giving advice
- Importance of approvals and actions allowed for circumventing any departmental staff positioned to provide controls
- Public and private responses to official communications and/or individuals on policies, control activities and guidance from above
- Commentary around the table
- Responses to problems, abuse, misuse or violations of expectations

Tone at the Top

“There is nothing more important to the University of Illinois than our reputation for honesty and good management. That is why all of us in the University community must protect and advance the good name the University has earned over its long and distinguished lifetime. Our obligation as employees is clear: we must be careful guardians of the University’s assets – its money, its equipment, its buildings and books – on behalf of the people of Illinois. In short, integrity is the bedrock of our institutional behavior.”

B. Joseph White

How YOU Can Improve the University's Control Environment

- Communicate clearly
- Accuracy counts...take your time
- Don't just talk the talk, *walk the talk*
- Check the public and private responses
- Use exceptions/errors as opportunities to teach what's right
- Don't let abuse or misuse go
- Don't be a party to circumvention of controls
- Perform an annual risk assessment in conjunction with a review / update of your unit's strategic plan

Typical Control Weaknesses

From routine audits

- **Segregation of duties** (P-Cards, purchasing, cash, equipment)
- **P-Card issues** (no independent reconciliation, sharing of P-Cards, stringing, lack of documentation, no reconciliation with travel vouchers)
- Incomplete **monthly reconciliation** process
- Purchase **contracts** missing, signed inappropriately, and executed after service had already commenced
- **Revenue-generating activities** lack controls (contracts, billing, collection)
- Management of **conflict of interest** process and management of conflicts identified (traditional, supervision of family members, civil service)
- **Gift** funding (inappropriate classification, expenditures not consistent with donor intent, accumulations without purpose, deficits)
- **Cash handling / sales revenue** functions (documentation of sales, timely deposits, refunds, reconciliations)
- **Storeroom management** (purchasing, inventory management, reconciliations)
- Review and supporting analysis for **fee structure**
- **Information Security**: Storage of system and data back-ups; Procedures for reacting to security incidents and business continuity plans; System access protocols (revocation, reviews); Review and supporting analysis for fee structure; Storage and handling of high risk data (credit card numbers and social security numbers, PCI standards)

Typical Control Weaknesses

From investigations

- P-Cards (sharing cards, not reconciling, lack of independent reconciler, non-compliance, no supporting documentation to support the business purpose)
- Travel expenditures (duplication through different units, inadequate support, not original)
- Contracting using memorandum of understanding (not appropriate for type of service, not getting appropriate signatures)
- Equipment record keeping (e.g., computer parts)
- Gifts from faculty deposited into funds that support his/her own program
- Employee performance evaluations

Possible Controls

How can you address noted control weaknesses?

SEGREGATION OF DUTIES	Review segregation of duties and systems access involving you; Be creative with mitigating controls; Look for processes missing another set of eyes
P-CARD MANAGEMENT	Review a sample of your unit's P-Card transactions; Identify and correct process weaknesses you detect; Ensure cards are not shared and all transactions are independently reconciled; Emphasize compliance responsibilities in staff meetings; Establish requirements for adequate supporting documentation to support the business purpose of the transaction
RECONCILIATIONS	Be sure to include all funds in your org and all transactions in those funds; Include OL and GL

How can you address noted control weaknesses?

CONTRACTING	Avoid using MOU's or other form of contract that is inappropriate for services received; Ensure contracts are appropriately approved, including by Legal Counsel if not using a standard form; Ensure appropriate signature: only one signature is authorized to execute agreements on behalf of the University (Comptroller) and should be attested by the signature of the Secretary of the BOT
REVENUE-GENERATING ACTIVITIES	Use contracts; Prepare timely billings – either independent of Banner (with permission) or in Banner GAR; Monitor receivables and collections.
CONFLICT OF INTEREST	Regular staff meetings for reminders (e.g., contract policies, conflict of interest, receipts, use of University resources)
GIFT FUNDING	Obtain Foundation reports on gift fund accumulations and establish a plan to use or reinvest them

How can you address noted control weaknesses?

CASH HANDLING / SALES REVENUE

Review procedures for documenting and recording sales, timeliness of deposits, segregated reconciliations, handling of refunds, and contracting procedures for revenue-generating agreements

STOREROOM MANAGEMENT

Establish appropriate inventory management practices, determine minimum optimal inventory levels and strive for just-in-time purchasing; Establish efficient purchasing procedures, including vendor and optimal purchase-quantity analyses; Segregate purchasing responsibilities from inventory management responsibilities and from sales responsibilities; Maintain perpetual inventory records; Perform regular reconciliations between perpetual inventory records and actual physical inventory; Regularly review sales and inventory levels to detect slow-moving or obsolete items, adjust purchasing habits accordingly

How can you address noted control weaknesses?

FEE STRUCTURES	Perform a detailed review of pricing policies for self supporting activities; Are prices consistent with / inclusive of costs charged to the activity?
INFORMATION SECURITY	Establish a disaster recovery plan appropriate to your unit... look at more than just business information technology - include fiscal location and communication if important; Establish procedures to periodically test your business continuity / disaster recovery plan; Develop and communicate a plan for security incidents; Establish procedures to revoke all system access (e.g., Banner, shadow systems, EDDIE, etc.) when employees leave your unit; periodically review system access for all employees and adjust according to responsibilities; Meet with operational and IT personnel to identify all areas of confidential data (e.g., SSN, credit card information) and discuss the policies for handling

How can you address weaknesses noted in investigations? (for topics not already covered)

DUPLICATE TRAVEL REIMBURSEMENTS	Communicate with other units which your faculty or staff have a dual relationship; Ensure reimbursements are supported by only ORIGINAL documentation
EQUIPMENT RECORDKEEPING	Take your Biennial Inventory seriously; Implement regular reconciliations or inventory spot-checks in the interim periods and ensure existence, condition, and location of equipment is accurate in the University record
GIFTS FROM FACULTY IN SUPPORT OF THEIR OWN PROGRAM(S)	Review potential conflicts of interest, ensure gifts are not used in support of the faculty's salary or benefits
EMPLOYEE PERFORMANCE EVALUATIONS	Ensure all performance evaluations are completed annually and appropriately documented

Your processes

Mainstream Business Cycles

- A. Revenue
- B. Cash Receipts
- C. Accounts Receivable
- D. Gifts
- E. Sponsored Programs
- F. Purchasing
- G. Expenditure
- H. P-Card Issues
- I. Personnel and Payroll
- J. Moveable Equipment
- K. Inventory
- L. Budget
- M. Information Security

Revenue Control Environment

- Adequate method for accumulating revenue, properly classifying the nature and source
- Timely processing of revenue transactions
- Adequate segregation of duties, including reconciliation of revenue amounts to supporting agreements or sales documents
- Identification and reporting of trends or anomalies
- Procedures for pricing reviews and budgeting for activities that generate revenues in accordance with Legislative Audit Commission Guidelines and UI policies
- Constant review and identification of tax reporting requirements
- Revenue contracts are compliant with OBFS; process to ensure they are billed is appropriately controlled

Cash Receipts Control Environment

- Issuance of and accounting for a pre-numbered receipt
- Independent reconciliation of receipts to cash deposited
- Safeguarding of cash and checks
- Timeliness of deposits
- Petty cash and change funds access, disbursement, and reconciliation procedures comply with policies
- Adequate segregation of duties between custody and record keeping
- Independent reconciliation of deposits
- Cash is not collected for items that should be processed through University accounts receivable

Accounts Receivable Control Environment

- Adequate segregation of duties (receiving payments, updating A/R balances, and reconciling)
- Authorization from OBFS if not using Banner A/R
- Approval of credit extension policies and billing controls
- Monitoring system access
- Monthly reconciliation to Banner A/R
- Proper reporting of A/R to OBFS at year end for unit managed receivables
- Procedures for monitoring aging, unit collection efforts, and write-offs

Gift Control Environment

- Classification and support (gift vs. grant and restricted vs. unrestricted)
- *Gift Transmittal Forms* and reporting to the Foundation
- Policies for acknowledgement letters by the Department
- Reviews of FACTS weekly gift reports
- On-going procedures to ensure compliance with donor intent
- Periodic evaluation of intent and status of each account / gift
- Monitoring of deficits and accumulations
- Preventing commingling of gift funds
- Managing Conflicts of Interest involving gift funds – gift from employee forms
- Costs associated with development efforts are appropriately coded as development costs

Sponsored Program Control Environment

- Individuals responsible for grant activity have received appropriate training and have reviewed OBFS §16, OMB Circular A-21, terms and conditions specific to the award, or other requirements, as applicable
- Restricted funds are used only for the intended purpose – documentation is adequate to support charges to the sponsored program or project
- Expenditures are reviewed for allowability, classification, consistency with the program/project agreement, and adequate funding prior to undertaking a transaction
- Compliance with technical portions of agreements
- Adequate procedures to identify and report cost sharing
- Subrecipient monitoring
- Deficit monitoring and follow-up
- Unusual transactions are identified, questioned, and adequately explained
- Effort: consistent with time spent, appropriately reviewed and reported
- Preaward period – proposals – key control opportunities!

Purchasing Control Environment

- Processes for review of adequate funding prior to initiation of purchase
- Processes for review of transactions for allowability
- Documentation supports purpose, costs, and approval
- Segregation of duties between approving, negotiating, and reconciling
- Approval authority is in line with organization authority
- Review and identification of stringing transactions
- Independent verification of goods received
- Proper approval of contracts
- Procedures to outline compliance terms for agreements and monitor
- Adequate knowledge and compliance with UI policies
- We don't start the work before the contract is executed

Expenditure Control Environment

- Adequate segregation of duties
- Approvals and delegations of approval authority are documented and reviewed periodically
- Expenditures are reviewed for allowability and availability of funds prior to payment
- Reconciliation to supporting documentation is timely
- Procedures are designed to review expenditures for compliance with contracts and UI policies, laws...
- Telecommunication expenditures are reviewed
- Communication and awareness of sales tax issues
- Individuals responsible for expenditure processes are aware of conflict of interest disclosures, including highlighting conflicts that exist within the purchasing function

P-Card Issues

P-Card is a tool used in the purchasing and expenditure cycles, special considerations for P-Card controls include:

- What does the reconciler really do?
 - CFOAPAL, business purpose, funding, policies, appropriateness
- What constitutes an “original” receipt?
 - Form and detail
- Who keeps the documentation?
- Common problems
 - Card sharing: P-Cards shared or retained in a “central” area
 - Account sharing
 - Sales taxes
 - Unreconciled transactions
 - Lack of discipline strategy or consistency with strategy
 - Lack of independent verification of goods received
 - Stringing
 - Lack of segregation of responsibilities

Personnel and Payroll Control Environment

- Documented authority
- Segregation of duties regarding appointments and time entry
- Timesheets are approved prior to payment
- Approved timesheets are not returned to the employee
- Management of Conflicts of Interest which involve direct supervision
- Monitoring benefit time usage, taking action when concerns arise
- Overtime pre-approval and monitoring
- Reconciliation of payroll detail to financial statements
- Timely performance reviews, reviews reflect pay raise actions taken
- Adequate termination procedures (access, safety, assets, etc...)
- Check distribution: compliance with policy
- Adequate documentation to support adjustments, lumps, and other non-standard pay changes

Moveable Equipment Control Environment

- Segregation of duties (custody, recording, verification)
- Tagging
- Equipment loan approval and forms
- Equipment monitoring < \$500
- Physical inventories are performed with review and evaluation of items not found
- Reconciliation of equipment records to any internal databases or spreadsheets
- Disposal procedures are communicated and effective
- Equipment purchased with grant funds is maintained appropriately
- Additional focus on risk areas (high dollar, small size, easily convertible)

Inventory Control Environment

- Security is adequate
- Perpetual records are maintained
- Physical counts and reconciliations (yearly reporting on FACTS if periodic) are performed
- Purchasing controls are documented
- Segregation of duties (ordering, receipt, recording) is adequate
- Cut-off procedures are reviewed every year for exceptions or new issues
- Management review and analysis of the stores, turnover, amounts, usage, shortages, overages, exceptions, etc

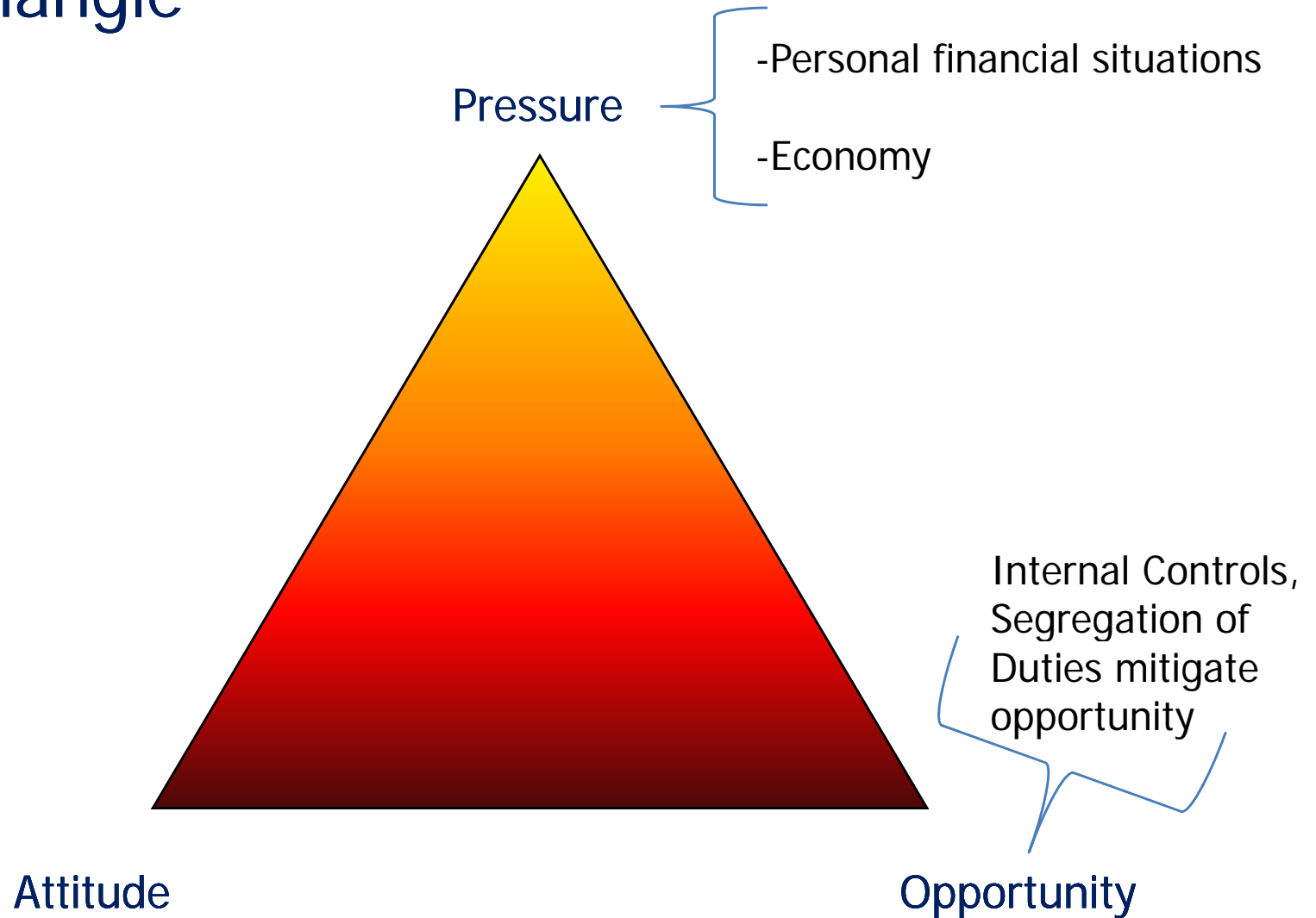
Budget Control Environment

- Financial reporting compares budget-to-actual on a level detailed enough to provide adequate oversight and is reviewed by the unit leadership and individual responsible parties
- Timely financial reconciliations are reviewed by individuals with adequate knowledge of the business unit
- Identification and resolution of inappropriate or inaccurate transactions
- Segregation of duties between reconciliations and processing
- Deficit review, follow-up, and reporting of action (reduction plans)
- Unit policies established and communicated
- Applicable staff and departmental faculty input in budgeting
- Consistent follow up on noted variations identified in reporting
- Conflict of Interest identification, administration, and communication to parties that have business roles
- Reconciliation (to Banner) and evaluation (needed?) of shadow systems
- Validation of reporting out of the data warehouse

Information Security Control Environment

- Passwords must not be shared and must meet the definition of a strong password available on the [CIO website](#)
- Back up critical data and store in an alternate location (not in the same building as production data and not at a residence)
- Disaster recovery plan: create, document and test
- Maintain user and system documentation for unique local applications/systems
- Classify and secure data according to the [Information Security Policy](#)
- Adequate security (firewall, intrusion detection) to protect servers with sensitive data
- **NO** SSN storage on departmental computing systems (exceptions must be approved by the [Office of Privacy and Information Assurance](#))
- Physically and environmentally secure facilities for storage of IT equipment (including temperature and humidity controls)
- Consider partnering with other units, departments, colleges, and organizations with similar IT requirements for increased efficiencies
- If your unit stores or processes credit card information, contact the [Director of Business Systems Analysis](#) in the Treasury Operations division of OBFS
- Procedures should exist to comply with the [University's Software Piracy Policy](#)

Fraud Triangle



“Quotable Quotes”

- “I thought she was doing that.”
- “The staff wouldn’t approve his transactions anymore, they would always bring them to me for approval.”
- “Everything she does is an exception.”
- “I could never get her to put that in writing.”
- “He wore me down.”
- “He was always sending emails after our discussions that would interpret things slightly different.”
- “We were concerned when saw the FOIA request.”
- “We only let him do it that one time. We told him next time it would not be approved.”
- “We don’t have enough staff to have adequate segregation of duties.”
- “She was mean to staff if they asked questions about her expenditures.”
- “I trust him.”

And In The End...

- Does it make sense?
- Is it all documented?
- Everyone that should have approved – did?

Given all of the information you have, would it pass the headline test?

References

- <http://www.obfs.uillinois.edu/>
OBFS homepage
- <http://www.obfs.uillinois.edu/manual/index.html>
OBFS Policy Manual
 - §9 Auditing, Internal Control, Employee Ethics
 - §19 Business Information Technology
 - §19.5 Information Security Policy (also found at <http://www.fs.uiuc.edu/cam/cam/viii/viii-1.2.html>)
 - §19.9 Software Piracy Policy
- <http://www.vpaa.uillinois.edu/policies/?bch=0>
University-Wide Policies
- <http://www.ssn.uillinois.edu/>
Social Security Number Policy
- <https://www-s.audits.uillinois.edu/IT/IT-BCP-introduction.html>
Business Continuity Planning
- <http://www.cio.illinois.edu/policies/passwords/index.html>
CIO Website
- <http://www.cites.illinois.edu/security/>
Office of Privacy and Information Assurance