

Common Internal Audit Findings and How to Avoid Them

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Today's Agenda

- Compliance Brown Bag Events
- Evaluation and Compliance Program Survey Tool.
- Purpose of the University Compliance Program
- Need for Good Corporate Governance
- Meet the Deloitte Team
- Overview of Internal Audit
- Risk and Internal Control Basics
- The Internal Audit Process
- Common Internal Audit Observations
- Wrap Up – What Are Your Compliance Responsibilities?

Welcome to a Compliance Brown Bag Lunch Event

- Information about these events:
 - *Informal (bring your lunch!)* Training or informative sessions that cover a variety of compliance related topics.
 - Open to all University community members, but each event will typically have a “target audience”.
 - If you like what you hear don’t be afraid to ask for a repeat presentation in your own department.
 - E-mail notifications of future events available – please contact boyd.kumher@case.edu to be added to distribution list.

Presentation Evaluation and Compliance Program Survey Tool

- Presentation Evaluation
 - Give us feedback so that we may enhance our performance and better select topics to meet your needs.
 - May be completed anonymously.
- Compliance Program Survey Tool
 - Help us understand the University's culture of compliance.
 - May be completed more than once per year.
 - May be completed anonymously.

Purpose of the University Compliance Program

- Develop and maintain an operational structure that outlines, documents and supports the University's compliance efforts.
- Coordinate compliance efforts and assesses University-wide compliance.
- Encourage compliance by providing support, training, and educational resources.

Internal Audit

- The Institute of Internal Auditors defines Internal Auditing as...
 - "An independent, objective assurance and consulting activity designed to add value and improve and organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."

Internal Audit

- Recognized need for good corporate governance.
 - 2010, Former University of Louisville dean sentenced to 5 years in prison after conviction in a \$2.3 million fraud case.
 - 2011, Former La Salle University food service director sentenced to 4 to 9 years in prison after conviction in a \$5.6 million fraud case.
 - 2011, Two former Southern University employees charged in alleged \$157,000 shell company scheme.



Meet the Deloitte Team

Meet the Deloitte Internal Audit Team

Core Team:

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Overview of Internal Audit

Overview of the CWRU / Deloitte Relationship

- **Background Information**
 - Engaged with CWRU since August 2008
 - Currently engaged through June 2012
- **Reporting Structure**
 - Administratively – John Sideras, Chief Financial Officer
 - Functionally – Audit Committee of the Board of Trustees
- **Contact Information**
 - We maintain a full-time on campus presence within the BioEnterprise Building (Corner of Cedar and MLK)
 - Phone Number: 216-368-4309
 - Email: internalaudit@case.edu

Overview of the CWRU / Deloitte Relationship

- **Major Responsibilities**

- Conduct annual enterprise-wide risk assessment
- Develop annual audit plan
- Perform reviews noted in the annual audit plan
- Follow-up on the implementation status of previously mutually agreed upon recommendations for improvement
- Special ad-hoc projects at the request of executive management
- Assist in monitoring and facilitating the Integrity Hotline
- Communicate with executive management and the Audit Committee

Please note: Unless you are an executive or an executive administrative assistant, we do not *routinely* audit your PCard / Reimbursement activity. These transactions are monitored by Kevin Dwenger and Michael Kurutz respectively.



Risk and Internal Controls Basics

What is Risk?

Risk* is “any event that can adversely affect the achievement of your objectives.”

* Internal Control – Integrated Framework, Committee of Sponsoring Organizations (COSO) of the Treadway Commission

Risk Types:

- Credit
- Organizational
- Position/Financial
- Operational
- Strategic
- Human
- Environmental
- Political
- Reputation
- Governance
- Technological

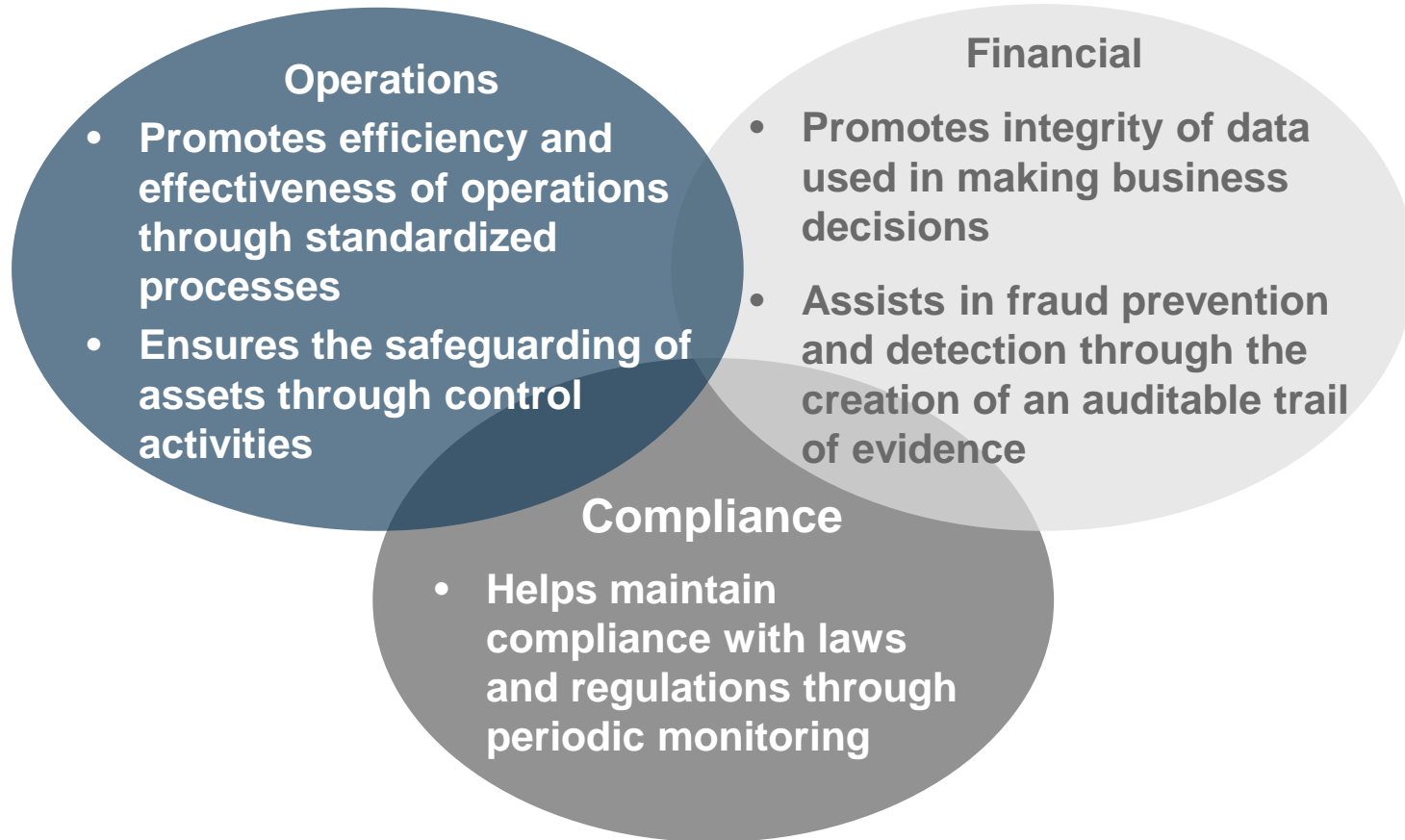
Techniques for Managing Risk

- Avoid: Redesign the process to avoid particular risks with the plan of reducing overall risk.
- Diversify: Spread the risk among numerous assets or processes to reduce the overall risk of loss or impairment.
- Share: Distribute a portion of the risk through a contract with another party, such as insurance.
- Transfer: Distribute all of the risk through a contract with another party, such as outsourcing.
- Accept: Allow minor risks to exist to avoid spending more on managing the risks than the potential harm.
- Control: Design activities to prevent, detect or contain adverse events or to promote positive outcomes.

What is Internal Control?

- Internal control means different things to different people
- Authoritative guidance defines **Internal Control*** as a process designed to provide reasonable assurance regarding the achievement of business objectives.
- Internal control has three main objectives:
 - To promote effectiveness and efficiency of **operations**
 - To ensure reliability of **financial** reporting
 - To maintain **compliance** with applicable laws and regulations
- * Internal Control – Integrated Framework, Committee of Sponsoring Organizations (COSO) of the Treadway Commission

Why is Internal Control Important?



Internal Control Definitions

Control Objectives

A goal of management (i.e., management directive). Control objectives pertain to various principal business process categories. Control objectives may be related to compliance with laws and regulations or the effectiveness and efficiency of the organization's operations.

Example: *Purchase orders are placed only for approved requisitions.*

Control Activities

Policies and procedures designed to help ensure that management directives are carried out. They help ensure that necessary actions are taken to address risks of not achieving the entity's objectives. The control activities relevant to an audit of financial statements are those that prevent or detect, on a timely basis, material misstatements in the financial statements or unauthorized disposition of assets or incurrence of liabilities.

Example: *Purchase orders are reviewed and approved by management prior to mailing to the supplier.*

Internal Control Definitions

Preventive Controls

Control activities established to prevent an error or misstatement in the financial statements. Typically these controls will be upstream at the front-end of a process or sub-process.

Example: *The ability to create a purchase order is appropriately restricted by job responsibility.*

Detective Controls

Control activities designed to detect an error or misstatement in the financial statements. These controls usually consist of performing reconciliations, management review or analysis and typically occur downstream in the process.

Example: *On a periodic basis, an analysis is performed to identify invoices received without a corresponding approved purchase requisition or purchase orders created AFTER the invoice date.*

Roles and Responsibilities

Executive Management (Including the University Compliance Officer)

- Sets the standard for the control environment
- Maintains ultimate accountability for internal control and risk management enterprise wide
- Supports control and risk management activities throughout the organization

Operating Management

- Directly responsible and accountable for business operations effectiveness and internal control related to business objectives
- Periodically assess departmental risk management practices and control environment
- Develops and implements action plans for improvement

Roles and Responsibilities

Internal Audit

- Provides support for risk and control assessment activities
- Monitors exposure of the organization and makes recommendations relating to risk and control activities
- Designs internal audit plan based on strategic risk assessment
- Tests adequacy and effectiveness of controls
- Challenges and validates management control environment assertions
- Reports independent findings and provides recommendations

Audit Committee

- Focuses board attention
- Evaluates overall risk exposure
- Reviews adequacy of overall control environment
- Provides oversight and advice

Roles and Responsibilities

External Audit

- Evaluates the effectiveness of internal control to determine the scope of external audit procedures
- Issues management commentary reports
- Issues an opinion on the consolidated financial statements
- Reviews control environment and uses results of risk assessments as input to develop external audit plan



The Internal Audit Process

Expectations for the Auditee

- Expect to be contacted prior to the commencement of a scheduled audit project
- Expect to understand the audit's purpose and objective
- Expect to provide your ideas or concerns regarding the audit
- Expect to be treated with respect and courtesy
- Expect to be asked for various financial and department documentation; some may be confidential
- Expect confidential information to remain confidential
- Expect to answer all questions honestly
- Expect to receive a draft copy of the Final Audit Report prior to its release

How to Prepare for an Audit

- Have all requested materials/records ready when requested
- Organize files so we minimize disruption of your day
- Provide complete files
- Please make yourself available during the time of the audit and communicate any planned absences
- Provide work space for auditors if requested

Audit Steps

- **Step 1: Planning** - The auditor will review any prior audits in your area and professional literature. The auditor will also research applicable policies and statutes and prepare a basic audit program to follow.
- **Step 2: Notification** - The Office of Audit Services will notify the appropriate department or department personnel regarding the upcoming audit and its purpose, at which time an opening meeting will be scheduled.
- **Step 3: Opening Meeting** - This meeting will include management and any administrative personnel involved in the audit. The audit's purpose and objective will be discussed as well as the audit program. The audit program may be adjusted based on information obtained during this meeting.
- **Step 4: Fieldwork** - This step includes the testing to be performed as well as interviews with appropriate department personnel.
- **Step 5: Report Drafting** - After the fieldwork is completed, a report is drafted. The report includes such areas as the objective and scope of the audit, relevant background, and the findings and recommendations for correction or improvement.

Audit Steps

- **Step 6: Management Response** - A draft audit report will be submitted to the management of the audited area for their review and responses to the recommendations. Management responses should include their action plan for correction.
- **Step 7: Closing Meeting** - This meeting is held with department management. The audit report and management responses will be reviewed and discussed. This is the time for questions and clarifications. Results of other audit procedures not discussed in the final report will be communicated at this meeting.
- **Step 8: Final Audit Report Distribution** - After the closing meeting, the final audit report with management responses is distributed to department personnel involved in the audit, the Chief Financial & Administrative Officer, and our external accounting firm.
- **Step 9: Follow-up** - Approximately 6-9 months after the audit report is issued, the Office of Audit Services will perform a follow-up review. The purpose of this review is to conclude whether or not the corrective actions were implemented.

Common Internal Audit Observations

Common Internal Audit Observations

1. Segregation of Duties

- Ensure tasks and process flows have a check and balance. For example:
 - A person who is responsible for collecting payments should not be responsible for creating the deposit and reconciling to source documents.

2. Lack of Written Policies and Procedures (Departmental)

- Major business transactions and related internal controls of a department's operations should be clearly documented, periodically reviewed and updated.

3. Lack of Awareness of Centralized University Policies

4. Lack of Formally Documented Approvals

- Evidence should be maintained to document independent approvals (e.g. reconciliations, departmental financial statements, etc.)

5. Absence of Supporting Documentation

- Transactions should be appropriately supported by documentation. For example:
 - Manual Journal Entries: Purpose, related source documents, approvals
 - Purchases: Requisition, competitive bidding, purchase order, invoice, approvals

Common Internal Audit Observations

7. Lack of Properly Safeguarding University Assets

- In more than one department we have noted cash/checks that were not properly safeguarded.

8. Inappropriate Information Security Access

- Critical or sensitive information should be appropriately restricted based on job duties.

9. Inaccurate Financial Reporting

- Examples include:
 - **Expenses**
 - Invoices – Not recorded as a liability upon commitment
 - Overtime – Not approved timely
 - **Revenue**
 - Receivables – Not recorded in PeopleSoft (booked when cash is received)
 - Income – Recorded as an offset to an expense account (500000 – 599999) rather than to an income account (400000 – 499999)



Wrap Up

What Are Your Compliance Responsibilities?

- Understand and adhere to the laws, regulations and institutional policies that relate to your work.
- Report non-compliance or suspected non-compliance *immediately*.
 - Supervisor
 - Compliance Officer (216-368-0833)
 - Integrity Hotline (Can be Anonymous)
 - Web: <https://www.caseintegrityhotline.com/>
 - Phone: 1-866-483-9367

**QUESTIONS OR
COMMENTS?**