

Internal Controls Case Studies

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UMC 247

Practical Applications of Internal Controls

Agenda

- Review internal controls
- How to analyze a case study
- Case study discussions
- Personal Strategies

Definition

- Internal Control is a process designed to provide reasonable assurance in achieving:
 - Effective and efficient operations
 - Reliable financial reporting
 - Compliance with laws and regulations

What Do Internal Controls Do?

- Internal controls designed to:
 - Safeguard assets
 - Ensure all transactions are recorded and all recorded transactions are real
 - Protect the University from litigation or loss of grants, gifts, or donations

How Internal Controls Work

- Provides *reasonable* not absolute assurance that objectives will be met
- *Reasonable* assurance should provide appropriate balance between risk and level of control
- In designing controls with reasonable assurance, the cost should not exceed the benefit

Conduct Risk Analysis

- Assess likelihood of the risk occurring
- Estimate potential impact if risk occurs
- Determine how risk should be managed

Questions To Ask When Identifying Risk

- What could go wrong?
- What assets do we need to protect?
- How could someone steal from the dept?
- What information do we most rely?
- What activities are regulated by the federal government?
- What's our greatest legal exposure?
- How do we protect our reputation?

Common Areas of High Risk

- Petty cash
- Travel
- Payroll
- A-card
- Equipment

Control Activities

- Actions or procedures that manage or reduce risk
- Preventive and Detective Controls
 - Preventive – attempt to deter or prevent undesirable events
 - Detective - attempt to detect undesirable events after the fact

Controls Activities Include

- Ask questions
- Approvals, authorizations, verifications
- Reconciliations—investigate exceptions
- Review performance of actual results to expected results
- Physically secure assets
- Separate duties

Who is Responsible for Ensuring University Assets are Protected?

- All employees of University are responsible for managing internal controls

Why Discuss Case Studies

- To foster a renewed or strengthened sense of confidence that you can effectively deal with departmental pressures while meeting institutional expectations and responsibilities

How to Analyze a Case Study

- Define the problem
- Understand what caused the problem
- Assess the risks
- Analyze existing controls
- Identify responsible parties
- Develop new controls or enhance existing controls
- Implement controls

Case 1: Personal Long Distance Calls

An employee fails to reimburse the university for personal long distance phone calls worth approximately \$5 a month on a regular basis. The situation occurs with the approval of the department head.

Should you, as the department administrator, accept the submission of the monthly telephone bill with no personal calls identified when you know personal calls occurred?

What are the possible risks of allowing this activity to continue?

Issues to Consider

- Regardless of the dollar amount, it is against state rules to use university resources for personal benefit.
- Individual's behavior could escalate
- Other employees may begin to think it is okay make personal calls
- Sets a "tone" of loose controls
- Potential damage to individual and/or department reputations
- IRS implications as transaction is tax free
- Monthly reimbursement process costly to department

Case 2: Student Organization Event

A student organization loosely related to your department asks you to process a \$50 payment to a presenter at one of their events. The funds for this organization are managed through Student Affairs, but the students ask you to process the payment through the department to ensure that it is made prior to the semester break. (A month has already passed since the date of the presentation and the students are concerned that unless the payment is processed right away, it will be delayed until the second semester.)

You call the Admin Assistant in Student Affairs who is responsible for managing student group funds and confirm that there is money in the student organization's account so reimbursement to your account should not be a problem.

Should you authorize and process the transaction?

What are the risks?

Issues to Consider

- Department will not be reimbursed by Student Affairs
- There was no speaker/event
- Individual already paid, department efforts results in speaker being paid twice
- Potential to adversely affect relationship with Student Affairs
- Confirmation of funds with Admin Assist does not convey authorization to reimburse
- How does this affect the relationship with student organization
- Does department administrator have authority to commit department funds

Case 3: Travel Voucher Error

While reviewing a travel reimbursement voucher you prepared and submitted for a faculty member, you notice that you have made a mistake. Because of complicated foreign currency conversions, you made unintentional errors in calculating the expense reimbursement. The faculty member was reimbursed an extra \$1,000 as a result of the error.

You believed the faculty member would have noticed the error upon receiving the check, but the faculty member never said anything and cashed the check.

What do you do?

What are the possible risks of doing nothing?

What the possible risks of correcting the error?

Case 4: Questionable Purchases at the Campus Bookstore

At Christmas time, your department head goes to the campus bookstore and charges a number of items on his A-card, including sweatshirts and polo shirts. He forwards the receipts totaling \$350 with instructions to allocate the charges to his college account; however, he does not attach documentation explaining the purpose of the purchases. You are concerned that the purchases might be personal expenses.

What are the key issues?

What additional information would you need?

What are the possible plans of action?

How could the situation have been avoided?

Case 5: Unallowable Travel Expenses

A faculty member who did a considerable amount of job-related traveling submitted expense reimbursement vouchers that included personal expenses not covered under the university's travel policy. The chair and department administrative staff did not closely review the expense vouchers, thereby allowing the employee to continue the practice of submitting unallowable expense. The employee continued to submit the expense vouchers believing that everything was okay because nobody had objected. Unallowable expenses identified totaled \$600.

Who should accept responsibility for the irregularity—the faculty member, the chair, or the administrative staff responsible for approving the vouchers?

How could this situation have been avoided?

Case 6: Hiring a Spouse

A faculty member hires an individual as a temporary employee to perform work. Another member of the department mentions to the department administrator that the temporary employee may be the faculty member's spouse. (The temporary employee has a different last name than the faculty member.) The department chair is aware of their hire. Neither the chair nor the faculty member has mentioned anything to you regarding a possible relationship. You receive bi-monthly time reports; however, this person is rarely in the office.

You are the department administrator and assume that the department chair would know if the faculty member and the temporary employee are related and would tell you if she thought you need to know.

What are the risks?

What should be done?

Case 7: Personal Use of University Equipment

You learn that three years ago a faculty member suggested to two professional research associates that they could perform testing as an outside firm for customers independent of the university. It was suggested that the two PRA's could use a specialized piece of laboratory equipment purchases through a government sponsored grant and reimburse the department for the use of the equipment on an hourly basis. The nature of the work the PRA's would perform in their business would be similar to the regular job responsibilities supporting the department faculty.

This was done, but no formal record-keeping systems were put in place. In the past three years, the business had revenues totaling about \$40,000, using about \$5,000 worth of equipment time. However, there is no accounting for the time the PRA's have spent working for the university versus the business and no payment was ever made for use of the equipment.

When questioned, the PRAs indicated that both the faculty member in charge and the department administrator at the time (both individuals have since left the university) knew and approved the arrangements.

What are the key issues?

Does the fact that the PRAs used equipment purchased through a government sponsored project make a difference?

Who is most responsible for this situation?

How could this situation have been avoided?

Case 8: Local Vendor Related to Department Employee

A university department makes extensive use of a particular set of services. Although several local companies are able to provide these services, the department is not required to contract through Purchasing for the services due to the nature of the work provided. The owner (wife) of one of the service companies seeking this work is married to an employee (husband) in the department. Her husband is not in a position to decide which company will provide the services, but he is one of the primary beneficiaries of the work provided. Contracts for the services are formally bid. The wife's company wins the majority of the contracts.

Is there a conflict of interest?

What are the risks in this situation?

Should the university contract with this vendor?

Should the dollar amount of the transaction make any difference?

Personal Strategies

- Create an environment in which it is okay to ask questions
- Do not assume superiors or subordinates understand the risks—you may do them a favor by explaining them.
- Apply the “Rocky Mountain news test”
- Do not compromise your standards and ethics
- Personalize the responsibility, accountability, and potential ramifications.

Summary

- Set the proper work environment so “doing right” is not only encouraged, but clearly expected.
- Understand your responsibilities in relation to the objectives of the university
- Assess the risks you are responsible for managing and actively manage against those risks.

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