Internal Control in Higher Education

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Audit Services’ Mission

To provide assurance and advisory services that are independent, objective and risk-based in order to protect Montana State University and to improve its operations.
Audit Services’ Responsibilities

- Assurance: Evaluate (internal) control processes
  - Monitor:
    - Compliance with policies, procedures laws and regulations
    - Means of safeguarding assets
    - Quality and continuous improvement in operations
- Provide advisory services
- Investigate suspected fiscal misconduct and review compliance hotline reports

Source: [http://www.montana.edu/audit/charter.html](http://www.montana.edu/audit/charter.html)

3 Lines of Defense for Risk Management

(Institute of Internal Auditors Position Paper, January 2013)

- Management and Personnel
  - Deans, Directors, Dept Heads, Faculty & Staff
- Risk and Compliance
  - UBS, OSP, SRM, Info Security, Research Compliance
- Internal Audit
Internal Control in Higher Ed Overview

- 5 elements and 17 principles of internal control
- Areas where internal control processes should commonly be implemented in higher ed
- Tools for assessing and improving internal control processes in your unit

Office of Management and Budget (OMB)
Circular A-81 §200.303 Internal controls.

The non-Federal entity must:
(a) Establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award.
OMB Circular A-81 §200.303 Internal controls.

These internal controls should be in compliance with guidance in “Standards for Internal Control in the Federal Government” issued by the Comptroller General of the United States and the “Internal Control Integrated Framework”, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

COSO Internal Control–Integrated Framework

• COSO (Committee of Sponsoring Organizations) of the Treadway Commission
  – American Accounting Association (AAA)
  – American Institute of Certified Public Accountants (AICPA)
  – Financial Executives International (FEI)
  – Institute of Management Accountants (IMA)
  – The Institute of Internal Auditors (IIA)
The Green Book

- *Standards for Internal Control in the Federal Government*
  - Government Accountability Office (GAO)
  - Comptroller General of the United States
  - “May also be adopted by state, local, and quasi-governmental entities as a framework for an internal control system”


Other Internal Control Frameworks

- Canadian Institute of Chartered Accountants Control Framework
- Control Objectives for Information and Related Technology (COBIT)
- International Organization for Standardization (ISO)
Green Book Internal Control Definition

Internal control is a process effected by an entity’s oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity will be achieved.


Green Book Internal Control Definition

These objectives and related risks can be broadly classified into one or more of the following three categories:

• **Operations** - Effectiveness and efficiency of operations
• **Reporting** - Reliability of reporting for internal and external use
• **Compliance** - Compliance with applicable laws and regulations

Green Book Internal Control Definition

Internal control comprises the plans, methods, policies, and procedures used to fulfill the mission, strategic plan, goals, and objectives of the entity.


Green Book Internal Control Definition

Internal control serves as the first line of defense in safeguarding assets.

Green Book Internal Control Definition

In short, internal control helps managers achieve desired results through effective stewardship of public resources.


Green Book Internal Control Definition

People are what make internal control work. Management is responsible for an effective internal control system. However, personnel throughout an entity play important roles in implementing and operating an effective internal control system.

International Organization for Standardization (ISO) Control Definition

Administrative, managerial, technical or legal methods for managing risk, including policies, procedures, guidelines, practices or organizational structures

Source: ISO 27000 Information security management systems.

ISO Risk Definition

Combination of the probability (likelihood) of an event and its consequence (impact)

Source: ISO 27000 Information security management systems.
Characteristics of Higher Education

- Large organizations
  - Offices with functional expertise (e.g., finance, sponsored programs, human resources)
- Decentralized
- Partially taxpayer funded
- Highly regulated
- Some managers do not have prior business-type experience

Five Components of Internal Control
17 Principles Support the Five Components

Control Environment

The oversight body and management establish and maintain an environment throughout the entity that sets a positive attitude toward internal control.

Control Environment - Principle 1

The oversight body and management demonstrate a commitment to integrity and ethical values.

1. Tone at the Top
2. Standards of Conduct
3. Adherence to Standards of Conduct


State of Montana Code of Ethics

- **Gifts** – You may not accept a substantial (> $50) gift or economic benefit

- **Self-Dealing** – You may not perform an official act which directly and substantially provides an economic benefit to a business in which you have a substantial financial interest

https://hr.mt.gov/Portals/78/newdocs/guidesandforms/standardsofconductguide.pdf
State of Montana Code of Ethics

• **Unwarranted Privileges** – You may not:
  – Contract or be employed within six months of termination by someone who contracts with the state involving matters with which you were directly involved during your employment with the state
  – Receive two salaries as a public employee for work during overlapping hours

https://hr.mt.gov/Portals/78/newdocs/guidesandforms/standardsofconductguide.pdf

State of Montana Code of Ethics

• **Public Property for Private Business Purposes** – You may not use public time, facilities, equipment, supplies, personnel, or funds for private business purposes.

https://hr.mt.gov/Portals/78/newdocs/guidesandforms/standardsofconductguide.pdf
Montana State University’s four campuses are committed to acting with integrity in their pursuit of excellence. As part of this commitment, the university has selected a private contractor, EthicsPoint, to provide an independent avenue for confidential reporting of concerns about suspected legal, regulatory or policy violations.

www.msucompliancehotline.ethicspoint.com

Reporting Suspected Legal, Regulatory and Policy Violations

Montana State University encourages all faculty, staff, students, and volunteers, acting in good faith, to report suspected legal, regulatory or policy violations. The university is committed to protecting individuals from retaliation for making a good faith report.

http://www.montana.edu/policy/reporting-violations/
Fiscal Misconduct Policy

Any employee or student associated with the University who knows of, or suspects, fiscal misconduct should promptly notify his or her supervisor or one of the Responsible Officials for his or her campus [Director of Audit Services, Legal Counsel, or Director of University Police].

If a supervisor is notified of suspected fiscal misconduct, he or she will promptly notify a Responsible Official.

http://www.montana.edu/policy/fiscal_misconduct/

Control Environment - Principle 2

The oversight body should oversee the entity’s internal control system.

1. Oversight Structure
2. Oversight for the Internal Control System
3. Input for Remediation of Deficiencies

BOR Policy 930.1 – Internal Audit Reports

An internal audit report for a campus of the Montana University System shall be provided to the Commissioner's Office when the report contains a conclusion that there has been or may have been a violation of institutional or system policy or of state or federal law.

http://mus.edu/borpol/bor900/930-1.pdf
Montana Code Annotated (MCA) 5-13-309.

Information from state agencies.

[...]

(3) The head of each state agency shall immediately notify both the attorney general and the legislative auditor in writing upon the discovery of any theft, actual or suspected, involving state money or property under that agency’s control or for which the agency is responsible.


Control Environment - Principle 3

Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity’s objectives.

1. Organizational Structure
2. Assignment of Responsibility and Delegation of Authority
3. Documentation of the Internal Control System

Organizational Structure

Principal Investigator Guide

- 1110.00 Responsibilities in Post-Award Administration
  - Office of Sponsored Programs Post-Award Responsibilities
  - PI Post-Award Responsibilities
  - Departmental Accountant/Business Managers Post-Award Responsibilities

Documentation of the Control System

• Establishing and communicating who, what, when, where and why of internal control execution to personnel
• Means to retain organizational knowledge that could be limited to a few personnel
• Means to communicate effective control design to outside parties (e.g., auditors)


MSU Policies and Procedures

• [http://www.montana.edu/policy/](http://www.montana.edu/policy/)
  – [http://www.montana.edu/policy/purchasing/](http://www.montana.edu/policy/purchasing/)
Guidance on Adequate Documentation

**Departmental Revenue Collection Procedures Model**
This document can be used by departments as a guide for the development or enhancement of their revenue collection procedures and can be tailored to each department's specific situation.

[http://www.montana.edu/audit/guidance.html](http://www.montana.edu/audit/guidance.html)

Control Environment - Principle 4

Management should demonstrate a commitment to recruit, develop, and retain competent individuals.

1. Expectations of Competence
2. Recruitment, Development, and Retention of Individuals
3. Succession and Contingency Plans and Preparation

Control Environment - Principle 5

Management should evaluate performance and hold individuals accountable for their internal control responsibilities.

1. Enforcement of Accountability
2. Consideration of Excessive Pressures


Risk Assessment

Management assesses the risks facing the entity as it seeks to achieve its objectives. This assessment provides the basis for developing appropriate risk responses.

Risk Assessment - Principle 6

Management should define objectives clearly to enable the identification of risks and define risk tolerances.

1. Definitions of Objectives
2. Definitions of Risk Tolerances


Definitions of Objectives

• For quantitative objectives, performance measures may be a targeted percentage or numerical value.
• For qualitative objectives, management may need to design performance measures that indicate a level or degree of performance, such as milestones.

MSU Strategic Objectives

Objective L.2: Increase graduation rates at MSU.

Metric L.2.1: By 2019, the bachelor’s graduation rate will increase from 51 percent to 65 percent as measured by the six-year graduation rate.

Metric L.2.4: By 2019, the first time, full time freshmen fail-to-fail retention rate will increase from 74 percent to 82 percent.

Definitions of Risk Tolerances

• Risk tolerance is the acceptable level of variation in performance relative to the achievement of objectives.
  – For financial reporting objectives, risk tolerance is typically expressed in terms of materiality.

Definitions of Risk Tolerances

- **Compliance objectives** - Concept of risk tolerance does not apply. An entity is either compliant or not compliant.


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Risk Assessment - Principle 7

Management should identify, analyze, and respond to risks related to achieving the defined objectives.

1. Identification of Risks
2. Analysis of Risks
3. Response to Risks

Guidance on Risk Assessment

**Internal Control Assessments**
These questionnaires were designed to make it easy for staff members to determine if their units have implemented many of the control activities that are commonly needed at MSU and are based on MSU and State of Montana policies and procedures and sound administrative practices.

http://www.montana.edu/audit/guidance.html

Accounting & Budgeting Control Assessment (CA)

- How do you ensure that all indexes are regularly monitored to know that you have adequate resources?
- Do you have plans for handling an unexpected deficit?
- Do you use a subsidiary accounting system (e.g., CatBooks)? How is it used? Is it regularly reconciled to Banner (monthly)?
- What reconciliations do you perform and at what frequency? What do you do if you detect errors or omissions?

http://www.montana.edu/audit/guidance.html
Human Resources CA

- Are regular, extra (e.g., overtime) and exception time (e.g., leave) reviewed and approved?
- Are termination checklists completed and properly approved when employees leave?
- Are Conflict of Interest Disclosure Statements made annually by all applicable employees?

http://www.montana.edu/audit/guidance.html

Information Security CA

- Are MSU information security policies and standards followed (e.g., MSU Enterprise Technology Management Policy)?
- Has your area identified the types of data for which it is responsible and ensured that is stored in accordance with the MSU Enterprise Data Stewardship Policy?
- Are information system access privileges for employees in your area periodically reviewed and accordingly changed or terminated?

http://www.montana.edu/audit/guidance.html
Information Security CA

- Unit personnel do not download software from unknown sources or open attachments or links included in email without first thinking about the potential for resulting information security issues.
- Software and operating system updates are applied immediately on unit information systems.

http://www.montana.edu/audit/guidance.html

OMB Circular A-81 §200.303 Internal controls.

(e) Take reasonable measures to safeguard protected personally identifiable information and other information the Federal awarding agency or pass-through entity designates as sensitive or the non-Federal entity considers sensitive consistent with applicable Federal, state and local laws regarding privacy and obligations of confidentiality.
Procurement & Disbursements CA

- Purchases are not manipulated (e.g., two payments of $4,900 for a single item) to avoid following procurement procedures.
- A written contracted services agreement exists for all purchased services from independent contractors that amount to $5,000 or more.
- Prior to entering into a contract, the unit determines whether the relationship with the person or firm is an employment relationship or an independent contractor relationship.

http://www.montana.edu/audit/guidance.html

Property Management CA

- The unit maintains capital and minor and sensitive equipment inventory listings.
- Sensitive property includes items that possess a special risk of theft due to marketability and/or portability or that present a risk to safety.
- Actual and suspected losses of assets are reported to MSU Property Management.
- University facilities and equipment are not used for personal gain (i.e., no personal use).

http://www.montana.edu/audit/guidance.html
Revenue Collection CA

- Procedures must prevent skimming at the initial receipt of revenue. Records of initial receipt must be retained to prove that all revenue received was deposited.
- The change fund is balanced each day it is in use (amount authorized for the change fund plus amount recorded as received that day equals amount on hand).
- If there is insufficient staff for ideal separation of duties, procedures are in place that compensate for the lack of separation (e.g., supervisory review).

http://www.montana.edu/audit/guidance.html

Safety & Risk Management CA

- Workers’ compensation issues are reported.
- International travel is approved and reported.
- Student travel is conducted in accordance with student travel policy (http://www2.montana.edu/policy/student_trips/)

http://www.montana.edu/audit/guidance.html
Sponsored Programs CA

- Costs charged to sponsored programs are allowable.
- Time and effort reporting is accurate, complete, timely and properly certified.
- Cost transfers are minimized, properly approved, completed in a timely manner and reasonable in amount and frequency.

http://www.montana.edu/audit/guidance.html

Risk Assessment - Principle 8

Management should consider the potential for fraud when identifying, analyzing, and responding to risks.

1. Types of Fraud
2. Fraud Risk Factors
3. Response to Fraud Risks

Fraud Risk Factors


Fiscal Misconduct Definition

Examples include:
- embezzlement;
- misappropriation of goods, services, or resources;
- diversion of assets;
- conflict of interest situations,
- violation of state or University fiscal policies and procedures and
- use of University facilities and equipment for personal gain; and
- any activity related to intentional wrongdoing and improper behavior related to state financial matters.

[http://www.montana.edu/policy/fiscal_misconduct/](http://www.montana.edu/policy/fiscal_misconduct/)
Where Fiscal Misconduct Typically Occurs in Higher Ed

- Purchasing card
- Revenue collection
- Conflict of interest
- Sponsored programs noncompliance
- Property management

Risk:
Use of purchasing card for personal (or other unallowable) expenses

Controls:
- Unit-level review of purchasing card reports
  - Staff member could review most transactions
  - Supervisor could review transactions conducted by report preparer
- Purchasing card only used by cardholder
Revenue collection

**Risk:** Revenue collected is misappropriated

**Controls:**
- Duties are segregated or compensating controls are implemented
  - Segregate collection from daily balancing/depositing
  - Records of initial receipt must be retained

Conflict of interest

**Risk:** Private interest negatively impacts an employee’s university activities

**Controls:**
- Conflicts of interest are disclosed
- Conflict management plans are developed and followed

http://www.montana.edu/policy/conflict_of_interest/
Sponsored programs noncompliance

**Risk:** Costs charged to sponsored programs are unallowable

**Controls:**
- PIs are knowledgeable of grant rules
- Grant accountants are empowered to question allowability of costs

Property management

**Risk:** Misappropriation of equipment

**Controls:**
- Property Management Office is contacted for compliant disposition of property
- Maintain listing of minor and sensitive equipment
- Physical inventories of this listing are conducted every two years
Risk Assessment - Principle 9

Management should identify, analyze, and respond to significant changes that could impact the internal control system.

1. Identification of Change
2. Analysis of and Response to Change


Control Activities

Control activities are the actions management establishes through policies and procedures to achieve objectives and respond to risks in the internal control system, which includes the entity's information system.

Control Activities - Principle 10

Management should design control activities to achieve objectives and respond to risks.

1. Response to Objectives and Risks
2. Design of Appropriate Types of Control Activities
3. Design of Control Activities at Various Levels
4. Segregation of Duties


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**Figure 6: Examples of Common Categories of Control Activities**

- Top-level reviews of actual performance
- Reviews by management at the functional or activity level
- Management of human capital
- Controls over information processing
- Physical control over vulnerable assets
- Establishment and review of performance measures and indicators
- Segregation of duties
- Proper execution of transactions
- Accurate and timely recording of transactions
- Access restrictions to and accountability for resources and records
- Appropriate documentation of transactions and internal control

Source: GAO. I GAO-14-704G


Segregation of Duties

**Authority** to execute transactions (e.g., can delete revenue transactions in software application)

**Custody** of assets (e.g., cash and checks)

**Recording** of transactions (e.g., preparation of bank deposit)

**Reviewing** transactions (e.g., reconciling bank statement)


Guidance from the State

- State Financial Services Division, Internal Control Documents ([http://sfsd.mt.gov/SAB/internalcontrols](http://sfsd.mt.gov/SAB/internalcontrols))
Control Activities - Principle 11

Management should design the entity’s information system and related control activities to achieve objectives and respond to risks.

1. Design of the Entity’s Information System
2. Design of Appropriate Types of Control Activities
3. Design of Information Technology Infrastructure
4. Design of Security Management
5. Design of Information Technology Acquisition, Development, and Maintenance


Information Processing Objectives

- **Completeness** - Transactions that occur are recorded and not understated.
- **Accuracy** - Transactions are recorded at the correct amount in the right account (and on a timely basis) at each stage of processing.
- **Validity** - Recorded transactions represent economic events that actually occurred and were executed according to prescribed procedures.

Information Security Objectives

• **Confidentiality** - Data, reports, and other outputs are safeguarded against unauthorized access.
• **Integrity** - Information is safeguarded against improper modification or destruction, which includes ensuring information’s nonrepudiation and authenticity.
• **Availability** - Data, reports, and other relevant information are readily available to users when needed.


Control Activities - Principle 12

Management should implement control activities through policies.

1. Documentation of Responsibilities through Policies
2. Periodic Review of Control Activities

Information and Communication

Effective information and communication are vital for an entity to achieve its objectives. Entity management needs access to relevant and reliable communication related to internal as well as external events.


Information & Communication - Principle 13

Management should use quality information to achieve the entity’s objectives.

1. Identification of Information Requirements
2. Relevant Data from Reliable Sources
3. Data Processed into Quality Information

Banner

Other Examples of Sources of Data

- Office of Planning & Analysis
- Minutes from committee meetings
- Web time entry system
- OSP effort reporting system
- Responses to surveys
- Office of Commissioner of Higher Education (OCHE) Data and Reports
Information & Communication - Principle 14

Management should internally communicate the necessary quality information to achieve the entity’s objectives.

1. Communication throughout the Entity
2. Appropriate Methods of Communication


Appropriate methods of communication

• Written
  – Formal document
  – Email (Use the newspaper test)
• Phone
• Face-to-face
Information & Communication - Principle 15

Management should externally communicate the necessary quality information to achieve the entity’s objectives.

1. Communication with External Parties
2. Appropriate Methods of Communication

Examples of Recipients of External Communications

- State agencies
  - Legislative Audit Division (LAD)
- Federal agencies
- The Integrated Postsecondary Education Data System (IPEDS)

Monitoring

Internal control monitoring assesses the quality of performance over time and promptly resolves the findings of audits and other reviews. Corrective actions are a necessary complement to control activities in order to achieve objectives.

Monitoring - Principle 16

Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.

1. Establishment of a Baseline
2. Internal Control System Monitoring
3. Evaluation of Results


Internal Control System Monitoring

- **Ongoing monitoring** – regular management and supervisory activities, comparisons, reconciliations, and other routine actions
- **Separate evaluations** – can be conducted by management or others such as internal auditors or management consultants
OMB Circular A-81
§200.303 Internal controls.

(c) Evaluate and monitor the non-Federal entity’s compliance with statute, regulations and the terms and conditions of Federal awards.

Monitoring - Principle 17

Management should remediate identified internal control deficiencies on a timely basis.

1. Reporting of Issues
2. Evaluation of Issues
3. Corrective Actions

OMB Circular A-81
§200.303 Internal controls.

(d) Take prompt action when instances of noncompliance are identified including noncompliance identified in audit findings.

Five Components of Internal Control
Limitations of Internal Control

- Human judgment
- External events
- Breakdowns
- Management override
- Collusion


THANKS!