Internal Controls and Fraud Risks

Chris Alger, Director of Financial Operations

10/26/2018
Agenda

- Introduction
- Internal Control Framework
- Components of Fraud
- What’s Next?
What are Internal Controls?

- The Committee of Sponsoring Organizations of the Treadway Commission (COSO) defines internal control as:
  - “a process, effected by an entity’s board of directors, management, and other personnel, designed to provide **reasonable assurance** regarding the achievement of objectives relating to operations, reporting and compliance”
Internal Control Objectives

• **Organizational:**
  – Reliable financial reporting
  – Operational effectiveness and efficiency
  – Compliance with laws and regulations

• **Transactional:**
  – Authorization
  – Completeness
  – Accuracy
  – Validity
COSO Framework Components

- Control Environment
- Risk Assessment
- Control Activities
- Information and Communication
- Monitoring Activities
Control Environment

- The “tone at the top” of the University
- Established by Cornell’s Board of Trustees and senior leadership
- The University demonstrates a commitment to integrity and ethical values
- Organizational structure and HR policies are the most effective means of incorporating these values across the University.
Cornell’s Control Environment

- The University demonstrates a commitment to integrity and ethical values
- Management establishes, with board oversight, structures, reporting lines, and appropriate authority and responsibility in the pursuit of objectives
- The University demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives
- The University holds individuals accountable for their internal control responsibilities in the pursuit of objectives
Risk Assessment

• What could go wrong?

• **Dynamic** and **iterative** process of identifying and analyzing risks to meeting the University’s objectives

• “Risk tolerance” is an important factor:
  – How likely is each risk to occur and how impactful could it potentially be to the University?
Materiality

- The dollar amount at which a reasonable person’s judgment would be impacted.
- Defined at both the institutional and unit levels.
- Calculated as a discretionary percentage of either: total operating budget, actual expenses, or actual revenues:
  - What is the unit’s level of risk tolerance?
  - What account(s) drive the unit’s operations?
    - AA&D vs. Facilities
## Cornell University Institutional Risk Inventory (The Macro View)

### Strategic

<table>
<thead>
<tr>
<th>Governance</th>
<th>4/32</th>
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<tr>
<td>Board Oversight</td>
<td>Board Performance</td>
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<td>Control Environment</td>
<td>Institutional Risk Management</td>
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<td>Policies &amp; Procedures</td>
<td>Social Responsibility</td>
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<th>Planning/Resource Allocation</th>
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<td>Affiliates and Partnerships</td>
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<td>Cost-Benefit of Admin Oversight</td>
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<td>Organizational Structure</td>
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<td>Strategic Planning &amp; Execution</td>
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<td>Third Party Relationships</td>
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<th>Major Transformation Initiatives</th>
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<td>Measurement &amp; Monitoring</td>
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<td>Program Planning &amp; Execution</td>
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<td>Technology Implementations</td>
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<th>Market Dynamics</th>
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<td>Alumni Relations</td>
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<td>Competition</td>
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<td>Internal Communications</td>
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<td>Macro-Economic Factors</td>
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<td>Research Competitiveness</td>
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<td>Socio-Political Issues</td>
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### Operational

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<th>Alumni Affairs &amp; Development</th>
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<td>Alumni Relations/Prospect Mgt.</td>
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<td>Donor Relations</td>
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<td>Admission Evaluation</td>
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<td>Diversity</td>
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<td>Registration</td>
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<th>Information Technology</th>
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<td>Data Center &amp; Systems Continuity</td>
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<td>Internet Outages</td>
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<td>IT Management &amp; Strategy</td>
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<td>IT Policies and Procedures</td>
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<td>Third Party Provider Dependencies</td>
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<th>Human Resources</th>
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<td>Compensation and Benefits</td>
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<td>Faculty Development</td>
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<td>Succession Planning</td>
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<td>Diversity</td>
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<td>Staff Development</td>
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### Legal & Compliance

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<th>Regulatory Compliance</th>
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<td>Conflicts of Interest</td>
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<td>Debt/SEC/Bank Compliance</td>
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<td>Drug &amp; Alcohol Use on Campus</td>
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<td>International/Activities abroad</td>
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<td>Minors on Campus</td>
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<td>Other States’ Authorizations for Business</td>
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<td>Research and Clinical Administration</td>
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<td>Health Insurance/Reimbursement</td>
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<th>Supply Chain</th>
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<td>Procurement</td>
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<th>Public Safety/Critical Infrastructure</th>
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<td>Continuity of Operations/Recovery</td>
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<td>Cyber Attack Response Readiness</td>
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<td>Gas, Power, Steam, Water Outages</td>
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<td>Physical Safety</td>
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### Financial

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<th>Accounting and Reporting</th>
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<td>Accounting Policies &amp; Procedures</td>
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<td>Appropriate Designation of Funds</td>
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<td>Budget and Planning</td>
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<td>Gifts Accounting</td>
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<td>Investment Accounting</td>
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<th>Capital/Debt Structure</th>
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<td>Debt Ratings</td>
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<td>Investor Relations</td>
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<td>Markets</td>
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<td>Valuation</td>
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<th>Insurance</th>
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<td>Insurance Policy Limit Adequacy</td>
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<td>Self-Insured Retention Levels</td>
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### 4 Domains, 26 Categories, 171 Inherent Risk Areas
Cornell University Top 40 Institutional Inherent Risk Areas

Resulting From e-Surveys and Normalization Process

Alphabetic Order

- China/Beijing Center
- Clinical Practice-Quality of Care & Patient Safety
- Conflicts of Interest
- Continuity of Business Unit Operations
- Cornell Tech/Ithaca/WCM Collaboration
- Cyber Security/Data Protection
- Data Center & IT Systems Continuity
- Debt Ratings
- Deferred Maintenance
- Digital/Distance Learning
- Donor Relations
- External Intrusions Into Institutional Decision Making
- Emergency Preparedness, Response, and Recovery
- Faculty Recruitment & Retention
- Fed/State Regulatory/Legislative Adverse Action/Scrutiny
- Institutional Risk Management Program
- International Travel, Health, Safety & Security
- International/Activities, Business Models, Contracting
- Investments Performance
- IT Governance & Strategy
- IT Infrastructure—Internal/3rd Party Cloud Services
- Laboratory and Residential Safety Compliance
- Medical Billing Compliance
- Policies & Procedures
- Research Enterprise (includes competitiveness)
- Research Grants & Contracts Administration
- Research Human Subjects Protection
- Staff Recruitment and Retention
- Strategic Fundraising Campaigns
- Strategic Planning & Execution
- Student Activities/Fraternity Organizations
- Student Financial Services
- Student Recruitment
- Student Well Being & Safety
- Technology Transformation Implementations
- Terrorist & Malicious Acts
- Title IX Program/Sexual Assault
- Transition/Change Management Capabilities
- Weill Cornell Medicine - Qatar
- Weill Cornell Physicians Network Expansion

Items in blue font are the institutional Tier 1 – Top 11 Inherent risk areas
Major Transaction Cycles

• Where is most of the activity taking place within each unit?
  – Procure to pay
  – Travel
  – Grants/Contracts
  – Contributions
“Heat Mapping” – Micro View

Where should we be allocating internal control resources?

![Heat Map Diagram]

- Cash theft
- Federal non-compliance
- Incomplete accruals
- Payroll error
- Equipment theft
- Inaccurate financial reporting
Control Activities

• Policies and procedures that provide reasonable assurance that control objectives are met and risk responses are carried out.

• Examples of control procedures:
  – Segregation of duties (authorization, recording, and custody)
  – Proper documentation and authorization of transactions
  – Account reconciliations
  – Independent checks on performance
  – Safeguarding of assets of data
Information and Communication

- Communication provides the information needed to carry out day-to-day internal control activities across campus, as well as to provide personnel across the University with an understanding of their internal control responsibilities and their importance to the achievement of objectives.

- Information must be complete, relevant and accurate in order to contribute to an effective internal control environment.
Monitoring

- Internal control environments can only be effective if they are periodically measured for success:
  - Internal audit
  - External audit
  - Management response to deficiencies identified
What Could Go Wrong?

6 Howard Employees Fired for Fraud

By Grace Bird // March 29, 2018

Six Howard University employees were fired last year for stealing money from the financial aid department, the president confirmed Wednesday.

An external auditor found that six staffers received grants and tuition remission that exceeded the total cost of attendance and took the difference, Howard president Wayne Frederick announced in a statement. The fraud took place between 2007 and 2016.

Allegations of fraud surfaced this week in an anonymous blog post on Medium, which has since been removed. The post claimed the employees misappropriated almost $1 million.

https://www.insidehighered.com/quicktakes/2018/03/29/6-howard-employees-fired-fraud
What Could Go Wrong?

5. Iona College

In March 2011, the former vice president of finance of Iona College in New York, Marie Thornton, pleaded guilty to embezzling more than $850,000 (£525,000) by issuing college cheques for her own use, using a college credit card for personal purchases and making false expenses claims.

Ms Thornton, a catholic nun also known as Sister Susie, committed the thefts over a period of 10 years.

4. Vassar College

In April 2011, Arthur Fisher, a project manager at Vassar College in New York, and his wife Jennifer Fisher, were sent to prison after they created a fictitious construction company and began charging the college for services that had not been performed.

The scheme netted $1.9 million (£1.2 million) over five years.

https://www.timeshighereducation.com/features/5-examples-of-fraud-that-universities-can-learn-from/2008457.article
What Could Go Wrong?

2. The University of Montana

In 2010, Christine Bitterman, who worked in the Residence Life office at the University of Montana, pleaded guilty to embezzling more than $300,000 (£186,000) over a period of seven years, the Missoulian reported.

She had been stealing student rent payments that had been made in cash.

1. The University of Vermont

In July 2012, Celine Bernier, a former administrative assistant with the University of Vermont, was sent to prison after pleading guilty to depositing university cheques totalling almost $46,000 (£28,500) into her personal account over a five-year period.

According to the Burlington Free Press, the university was tipped off by a letter from Community National Bank that contained a check for $1,425 payable to UVM Extension - the university's community outreach arm - that had been deposited into Ms Bernier's personal account.

https://www.timeshighereducation.com/features/5-examples-of-fraud-that-universities-can-learn-from/2008457.article
Red Flags

The Fraud Triangle by Donald R. Cressey
How is Fraud Detected?

Source: ACFE’s 2018 Report to the Nation
Why Fraud Occurs

INTERNAL CONTROL WEAKNESSES
WERE RESPONSIBLE FOR NEARLY
HALF OF FRAUDS

ALL 18 ANTI-FRAUD CONTROLS
ANALYZED WERE ASSOCIATED
WITH LOWER FRAUD LOSSES
AND QUICKER DETECTION

Owners/executives
accounted for
a small percentage
of cases

but caused a
median loss of
$850,000

LOSSES CAUSED BY MEN
WERE 75% LARGER
than losses caused by women

MEDIAN LOSSES
ARE FAR GREATER
when fraudsters
collude

Source: ACFE’s 2018 Report to the Nation
Who’s Committing Fraud?

Source: ACFE’s 2018 Report to the Nation
Anti-Fraud Controls

- **The most effective anti-fraud controls:**
  - Code of conduct
  - Proactive data monitoring/analysis
  - Surprise audits
  - External audit of internal controls over financial reporting
  - Management review
  - Whistleblower hotline
  - Internal audit department
  - Fraud training for employees

Source: ACFE’s 2018 Report to the Nation
Cornell’s Internal Control Objectives

- Strengthen our existing internal control framework
- Assist unit leadership in accepting responsibility for the internal control framework within their units
  - Working with DFA to develop, implement and maintain a unit-specific internal control plan
  - Focus on identifying high-risk areas
  - Utilize heat mapping and materiality to determine where resources should be allocated
Partnership

- Internal Control Policy Committee
- Colleges and Divisions
- Division of Financial Affairs
- University Audit Office
Internal Control Policy Committee

• Establish, review, implement, document, and support the university’s internal control framework
• Determine strategies
• Generate Management Representation Letter
• Assist in:
  – Training financial managers and administrators
  – Evaluating controls
  – Making recommendations
  – Monitoring results
Subcommittees

• Policy development

• Risk assessment and materiality analyses in the units

• Unit-specific Internal Control plans and procedure development

• Training Guide

• Templates and tools for evaluating control structure

• Management Representation Letters
Colleges and Divisions Roles and Responsibilities

Analyze transaction cycles and assess the risk that fraud or a material financial misstatement could occur

• The risk assessment and heat map process will identify high-risk areas.

• For these areas, we will have a higher level of awareness for the possibility of fraud and/or misstatement.
Division of Financial Affairs – Director of Financial Operations

• Develop internal control policy and framework
• Work with units to perform risk assessments and develop a unit-specific customized Internal Control Plan
• Provide unit training as requested
• Suggest/provide tools/templates
University Audit Office

- Provide input during the development of unit-specific internal control plans (ICP)
- Monitor compliance to the ICP
- Suggest/provide tools/templates
What’s Next?

• The overall Internal Control Policy has been drafted and is currently under review.

• Process mapping for DFA is to be completed by 2/28/19.

• DFA will prepare the first unit-specific Internal Control Plan (ICP).

• DFA will then assist units in performing individual risk assessments and unit-specific ICP’s.
Questions