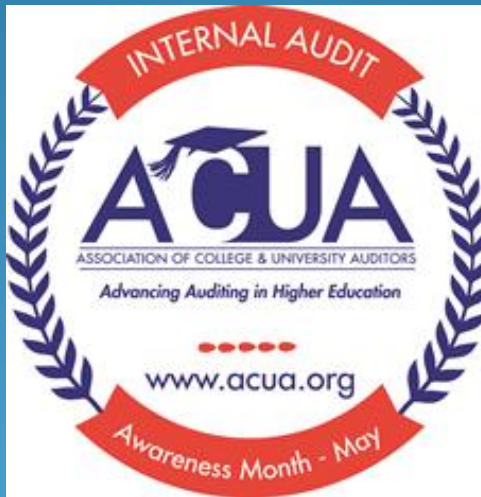# Everything You Wanted to Know About Internal Audit (but were afraid to ask!)

2016 UA Statewide Office of Audit and Consulting Services

Objectives of Presentation

➢ Provide a basic understanding of internal audit

➢ Provide a basic awareness of the principles of internal controls so:

- ➢ You have an understanding of what we're looking for as we conduct audits

- ➢ You can help us identify risks (potential problems) that warrant attention

Presentation Topics

1) About Internal Audit at UA
2) Typical Audit Process at UA
3) Internal Controls Overview
4) Best Practices for Internal Controls
5) UA Confidential Hotline

What is Internal Audit?

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an 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.

-Institute of Internal Auditors

-UA Regents' Policy P05.03.012

Who is Internal Audit at UA?

- We are a UA system office located in Fairbanks, comprised of:
- Chief audit executive (CAE) and four auditors
  - 1 information systems auditor with CISA certification (certified information systems auditor)
  - 1 senior auditor
  - 1 assistant auditor
    - working towards CIA certification (certified internal auditor)
  - 1 auditor vacancy; see UAKjobs!
  - 1-2 interns from the UAF School of Management when budget permits
- CAE reports administratively to the chief financial officer and functionally to the Board of Regents Audit Committee
- Location of department at the system level and the dual reporting lines = independent and objective audit function

What Does Internal Audit Do?

- We examine how University departments and processes operate
- Our work is guided by multiple sets of auditing standards
- Our emphasis is on:
  - Mitigating risk by evaluating controls
  - Identifying opportunities for greater efficiency
  - Compliance with applicable BOR Policy, University Regulation, and other regulatory requirements
  - Compliance with contract terms and conditions, grant award, budget justification, amendments

Examples of Audit Types and Topics

- Financial
  - Revenues, cash receipts, procurement card, budget
- Performance
  - Distance education delivery
- Operational
  - Review of a department's key operational processes
- Compliance
  - Effort reporting
  - Sub-awards/sub-recipient monitoring
  - FERPA
  - PCI DSS

Standards for Internal Audit

- Government Accountability Office Comptroller General of the United States
  - Generally Accepted Government Audit Standards
- Institute of Internal Auditors
  - Standards for the Professional Practice of Internal Auditing
  - Code of Ethics
- ISACA
  - Guidelines for the performance of information technology audits
  - Code of Ethics

University Audit Process

- Prepare annual audit plan
- Conduct internal audit planning and opening meeting
- Perform audit fieldwork
- Conduct preliminary closing meeting
- Obtain management responses
- Draft audit report and distribute
- Incorporate draft report comments and distribute the preliminary report
- Use the formal management responses to finalize and distribute the final report
- Perform audit follow-up

Authoritative Guidance

- Board of Regents Policy
- University Regulation
- Statewide Accounting and Administrative Manual
- OMB Uniform Guidance
- OMB Memorandums
- Federal Acquisition Regulations (FAR)
- State Statutes (ex: for reimbursable service agreements)
- University policy manuals
- Grants and Contracts Information Manuals
- Department-specific procedures

Typical Audit Process – Slide 1 of 10

Two of our audit process goals are:

❖**No surprises to the audit customer**

❖**On-going communication with the audit customer**

Exception to the typical audit process: When the engagement is an investigation

Typical Audit Process – Slide 2

1) Notification to management of the unit(s)to be audited

- This is considered to be the informal notification

  - Discussion is held of tentative audit scope, management concerns, timing of fieldwork, points of contact, assignment of audit staff, and overview of the audit process

2) Entrance letter to the chancellor, with a copy to the relevant department(s) involved in the audit

- This is considered to be the formal notification and occurs only after the informal notification(s) have been made and a timeframe for fieldwork has been determined

Typical Audit Process – Slide 3

3) Lead auditor sends a preliminary request for information to the stated point of contact

4) The unit audited will have a deadline for response to the preliminary request for information

- Deadlines can be flexible if the auditor is made aware of circumstances faced by the unit being audited

- The information provided in response is very helpful to the auditor

Typical Audit Process – Slide 4

5) The auditor conducts preliminary fieldwork, such as:

- Reviewing the response to the preliminary request for information
- Discussing functions and processes to be audited
- Continuing data analysis and selecting samples for the test work (unless already done for the prelim request)
- Performing test work steps, if possible, based on the response to the preliminary request
- Preparing for on-site fieldwork

Typical Audit Process – Slide 5

6) Fieldwork

- Auditors may be on-site for one work week or fieldwork will be conducted via electronic and telephonic means

- The auditor conducts internal control questionnaires (ICQs) with relevant staff for the different processes in the audit scope

- The auditor conducts test work procedures for the sample(s) of transactions selected

Typical Audit Process – Slide 6

When the auditor provides a selection for test work, it is accompanied by a list of documentation that is requested for each item in the selection

- An example of payroll test work selection:
  - 25 payroll transactions
- Likely requested documentation (we love OnBase!)
  - Time sheets
  - Job form or EPAF details that cover the specific job assignment for that pay period
  - Appointment letter

Typical Audit Process – Slide 7

The exit meeting:

❖ Used to present the audit observations noted during the fieldwork, and explain any areas of fieldwork that remain in progress. We provide a copy of our findings and recommendations document and review each observation with the exit attendees.

❖ It is very important that:

  ❖ We obtain agreement or disagreement to each finding and recommendation

  ❖ Recommendations are carefully reviewed for reasonableness by the department audited

Typical Audit Process – Slide 8

There are five parts to each set of finding and recommendation:

1. Issue: A description of the finding
2. Criterion: The authoritative guidance used to determine that a finding exists
3. Effect: The risk involved with the finding
4. Cause: The reason the condition (finding) exists
5. Recommendation: Suggested solution for the finding
6. Response: Agreement or disagreement; changes to the suggested recommendation

Typical Audit Process – Slide 9

Reporting:

- The draft audit report is prepared by the auditor and sent to the unit audited for their review for accuracy, clarity, and reasonableness. There are ten business days for this review period.

- The preliminary audit report is the formalization of the draft audit report after any review comments have been resolved or incorporated into the report. This report is distributed from the CAE, through the chief financial officer, to the chancellor.

- There is a three-to-five week period for submission of the formal response, which includes a plan of action for each finding and the planned implementation date(s).

- The associate vice chancellor for administrative services works with the audited unit(s) on their formal response.

Typical Audit Process – Slide 10

- The formal response is received by the CAE and chief financial officer.

- Upon acceptance by the chief financial officer, the response is added to the preliminary audit report and, collectively, these become the final audit report.

- The final audit report is distributed to the chair of the BOR Audit Committee, and copied to the chancellor, vice chancellor, and department(s)audited.

- The final audit reports are discussed at the next regularly scheduled BOR Audit Committee meeting. These are usually discussed in open session and anyone is welcome to attend.

Common Audit Findings

- Internal Controls (these occur throughout different types of processes):
  - Lack of departmental written procedures
  - Lack of approval or proper approvals
  - Undocumented dated approvals
  - Inadequate documented justifications
  - Lack of or inadequate back up documentation
  - Lack of adequate training

Definition of Internal Controls

A process effected by an organization's **people**, designed to provide **reasonable assurance** in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with laws and regulations

- COSO definition Committee of Sponsoring Organizations of the Treadway Commission

What are Internal Controls – How do people factor in?

- Internal controls are PEOPLE dependent
- Internal controls:
  - Are developed by people
  - Guide people
  - Provide accountability to people
  - Are carried out by people

What are Internal Controls - How is reasonable assurance achieved?

Too little control presents undue risk

Excessive controls are costly and counterproductive

Undue risks cause:

- Loss of assets, donors or grants
- Poor business decisions
- Noncompliance
- Increased regulations
- Public scandals

Excessive controls cause:

- Increased bureaucracy
- Reduced productivity
- Increased complexity
- Increased cycle time
- Increase of no-value activities

Three Control Categories

❖Effectiveness and efficiency of operations
 ❖Processes run smoothly and help us meet our objectives

❖Reliability of financial reporting
 ❖Numbers are accurate and are an aid to decision-making

❖Compliance with laws and regulations
 ❖Stay out of trouble

To Put Another Way…

"Internal controls can be defined as those processes that management relies on to make sure things don't get goofed up."

-Paul Kanneman

Who is Responsible for Internal Controls?

1. **Managers** are responsible for ensuring that internal controls are established, balanced, and operating as intended.

2. **Audit and Consulting Services** provides an independent evaluation of the adequacy of internal controls and reports the results to appropriate management and the Board of Regents Audit Committee.

3. **You!** Everyone has a role in internal controls. Why?
   1. Internal controls are not something that are simply laid on top of an organization.
   2. Internal controls must permeate the organization.

   http://alaska.edu/audit/internal-controls/

Internal Control Pyramid
(Categories described on next slides)

Control Environment

The "tone at the top" provides the <u>foundation.</u>

Includes the following elements:

➤ Demonstrates commitment to integrity and ethics

➤ Exercises oversight responsibility

➤ Establishes structure, authority, and responsibility

➤ Demonstrates commitment to competence

➤ Enforces accountability

Risk Assessment

Recognizing potential problems and ensuring there are procedures to deal with them.

Four Steps to Risk Assessment

➤ Establish objectives
  ❖ What do you want to achieve?
➤ Identify risks
  ❖ What can happen?
➤ Plan risk management
  ❖ What is our response?
➤ Plan for change
  ❖ Implement control activities

Internal Risk Factors

- New personnel
- Change in management responsibilities
- Revamped information systems
- New programs
- Communication
- Student needs or expectations

External Risk Factors

- Economic environment
- New legislation or regulations
- New technology
- Natural disasters, criminal or terrorist actions
- Community needs or expectations
- Vendor/Contractor performance and reliability

Control Activities

➤ Preventative
- ❖ Approval
- ❖ Authorization
- ❖ Security
- ❖ Segregation of duties

➤ Detective
- ❖ Verification
- ❖ Reconciliation
- ❖ Review

Let's Practice!

➢ Identify the risk(s), and
➢ A control activity that could have reduced the risk

Problem

➢ Because of the time the department secretary has spent reconstructing the department chair's research, other tasks are low priority. The secretary keeps cash receipts (cash and checks) in an unlocked desk drawer. The drawer contains $2000 in cash and 40 checks totaling $3000. Some checks are more than six months old. Some have not been endorsed and other have been endorsed "University name."

Risks and Controls

- Risks
  - Lost or stolen cash and checks
  - Stale checks
  - Budget shortfall
- Controls
  - Restrictive endorsements
  - Secure location
  - Cash receipts journal or log
  - Frequent, timely deposits
  - Verify deposits
  - Department head review

Information & Communication

➢ Systems or processes that support the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.

Monitoring

➤ Processes used to assess the quality of internal performance over time. Ongoing monitoring occurs in the ordinary course of operations, and includes regular management and supervisory activities.

Best Practices for Internal Controls

List of 10 Best Practices

1. Guard your signature and what it is being used for
2. Protect your passwords
3. Prevent and detect fraud
4. Document! Document! Document!
5. Separation of duties
6. Use computer resources smartly
7. Policies and procedures
8. Use the tools and resources available
9. Protect cash and other assets
10. Be, or contribute to, the 'tone at the top'

UA Confidential Hotline

- Available to all UA locations system-wide
- Third-party hosted to provide the option of anonymity
- Use for reporting **critical**, **high-risk violations**
- Confidentiality is fundamental; see the FAQ at www.alaska.ethicspoint.com
- Need to file a report?
  - Web Intake: www.alaska.ethicspoint.com
  - Toll-free Telephone: 855-251-5719

UA Confidential Hotline

Examples of issues to report using the UA Confidential Hotline *	
*For complete list, see **www.alaska.ethicspoint.com***	
Accounting and Financial	Fraud, theft, waste or other financial misconduct
Athletics	NCAA compliance or rules violations issues
Diversity and Equal Opportunity	Including bias incidents and EEOC or ADA matters, Title IX
Healthcare	HIPAA, healthcare fraud, insurance issues
Human Resources	Time or benefits abuse, employee misconduct, retaliation
Information Security	Data privacy/integrity, malicious use of technology
Research	Export controls, animal or human research issues, misappropriation of funds
Risk and Safety Matters	Unsafe working conditions, environmental issues or other safety matters, protection of minors

Questions?

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