



# **DEVELOPING AN EFFECTIVE INTERNAL CONTROL ENVIRONMENT AND SAFEGUARDING AGAINST FRAUD**

**Advancing into Management Program (AIM)**

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# Presentation Outline

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- **Role of the Internal Audit Department**
- **Departmental Audits: Objectives**
- **Components of Effective Internal Control**
- **Fraud and Financial Impropriety**



# The Role of Internal Audit

- **Management Auditors - provide assurance to senior management about internal controls, efficiency of operations and safeguarding of assets**

# Other Auditors


- **External Auditors - Ernst & Young LLP**
- **Funded Research Auditors - NSERC, SSHRC, CIHR, MOH**
- **Canada Customs and Revenue Auditors (CCRA)**
- **Federal and Provincial Government Auditors (GST/PST/EHT/etc.)**
- **Provincial Auditor**



# Departmental Audit Objectives

## • To Assess and Report on:

- Adequacy and Effectiveness of Systems of Internal Control
- Compliance with University and Sponsor Policies and Procedures
- Efficiency and Effectiveness of Financial Administration



# Audit Objective 1 - Adequacy and Effectiveness of Systems of Internal Control

## ⊗ Definition

- “Control support(s) people in the achievement of the organization’s objectives ... Control is what makes an organization reliable in achieving its objectives”
  - from Guidance on Control, The Canadian Institute of Chartered Accountants



# 5 Components of Internal Control:

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- Risk Assessment
- Control Environment
- Control Activities
- Monitoring Systems
- Information Systems



# Component 1: Risk Assessment

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## **Risk Defined:**

**the probability that events or actions may jeopardize the achievement of the University's objectives**





# Risk Factors

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- **Management's integrity - 'Tone at the Top'**
- **Effectiveness of Internal Controls**
- **Complexity of Operations**
- **External Exposure**
- **Liquidity of Assets**
- **Changes in Key Personnel**
- **Size of operating, research, trust and capital budgets**



# Effects of Risk

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- ❁ **failure to attain objectives and goals**
- ❁ **erroneous decision making**
- ❁ **erroneous record keeping, inappropriate accounting practices, fraud, fraudulent financial reporting, loss and exposure**

# Effects of Risk

- ❁ failure to safeguard assets
- ❁ 'customer' dissatisfaction, negative publicity, damage to reputation
- ❁ non-compliance with policy, plans, procedures, laws
- ❁ acquiring resources uneconomically or using them inefficiently or ineffectively



# Component 2: Control Environment

- ⊗ Integrity
- ⊗ Ethical Values
- ⊗ Competence
- ⊗ Organization

# Control Environment - Segregation of Duties

- **Asset Transactions have three components:**
  - **Initiating/Authorization**
  - **Recording & Reconciliation**
  - **Custody**
- **No one person should be responsible for all three**

# Lack of Segregation of Duties

## ⊗ Frequent Causes:

- Delegation of Authority
- Resource Limitations

## ⊗ Effects:

- Lack of effective control
- Increased risk of errors and improprieties

# Component 3: Control Activities


## • University Policies and Procedures

- Guide to Financial Management (GFM)
- Purchasing Policy/Purchasing Card Guidelines
- Taxation of Payments Manual
- Human Resources - Administrative Staff Policies

# Control Activities

- **Funded Research Sponsor Requirements**
  - Federal Granting Agency Guidelines - NSERC, SSHRC, CIHR
  - Funded Research Digests (FReDs) - RIS
- **Legislative Requirements**
  - Health and Safety
  - Employment Standards Act
  - Sales tax legislation





# **Component 4: Monitoring - Departmental and Central**

- **Departmental - Review and reconciliation of Fund and Fund Center Statements of Account and Payroll Distributions and Management Reports**
- **Central monitoring - Financial Services Dept., Procurement Services, Internal Audit**

# Monitoring - Department Head and PI Review

## • Objectives:


- Provides assurance that transactions recorded in AMS are complete, accurate and authorized.
- Provides reliable information about the source, use and availability of funds.
- Assists with detection of errors and/or improprieties.

# Component 5: Information Systems

## • Central


- FIS
- HRIS
- RIS
- DIS
- ROSI

## • Departmental



# **Audit Objective 2 - Compliance with University and Sponsor Policies and Procedures**

- **University Policies and Procedures**
- **Sponsor requirements**
- **Laws and Regulations**



# **Audit Objective 3 - Efficiency and Effectiveness of Financial Administration**

## **• Objectives:**

- Streamline workflow -identify redundant activities**
- Minimize costs - identify non-value added processes and controls**
- Skills Assessment - Training**



# Fraud and Financial Impropriety

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- **Reporting Incidents of Suspected Financial Impropriety**

# Fraud and Financial Impropriety

## • Statistics:

- 25% of employees committed or witnessed fraud
- 34% of employees reported a fraud to employer
- 80% of employers say they were defrauded by employees
  - Ernst & Young- Fraud Survey 2000

# Fraud and Financial Impropriety

- **Estimated annual cost in North America exceeds \$100 billion**
- **75% of all fraud goes undetected**
- **Nearly 70% of all fraud involve former or current employees , suppliers or customers.**





# Fraud and Financial Impropriety

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 "Red Flags"

# Fraud and Financial Impropriety

## • How to safeguard against it:

- Set the Right Tone
- Review and Reconciliation
- Adequate supervision
- Segregate inappropriate combinations of duties

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