



Welcome

UW-Madison Financial Forum

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Contributing to
the Wisconsin Idea
through Financial Responsibility



WISCONSIN
UNIVERSITY OF WISCONSIN-MADISON

UW-Madison Financial Forum

February 25, 2014



Contributing to the Wisconsin Idea through Financial Responsibility

Financial Forum: Internal Control: What does it Mean for UW?

Dr. Larry E. Rittenberg
Emeritus Professor
University of Wisconsin

February 25, 2014

Introduction – My Background

- Faculty member, School of Business, 1976 – 2013
- Ernst & Young Professor of Accounting
- Chair of Accounting Department for 11 years
- Active Professionally, served as Chair of COSO for 5 years, 13 years total on board.
- Board Member and Audit Committee Chair of \$2 Billion Company
- Former Audit Committee Member of Petro China

Objectives

When we Finish Today you should Understand:

- **The Nature of Internal Control** – it is all about accomplishing objectives efficiently and effectively
- **The Financial Initiative: Why Now.**
- **Your Responsibilities**
- **The Expected Outcome and**
- **Why Improved Internal Controls should make your Life Better**

Why Now

- Strong Support from **Chancellor Blank** and **Vice-Chancellor Bazzell**
- Commitment from Assistant Vice Chancellor of Business Services
- Discussion with Deans
- **Basic Premise:** *We need reliable, timely, and informative processes to sustain the greatness of this University.*

Why Now?

- **Need to Understand the RISKS that UW Faces:**

- **Reputation**

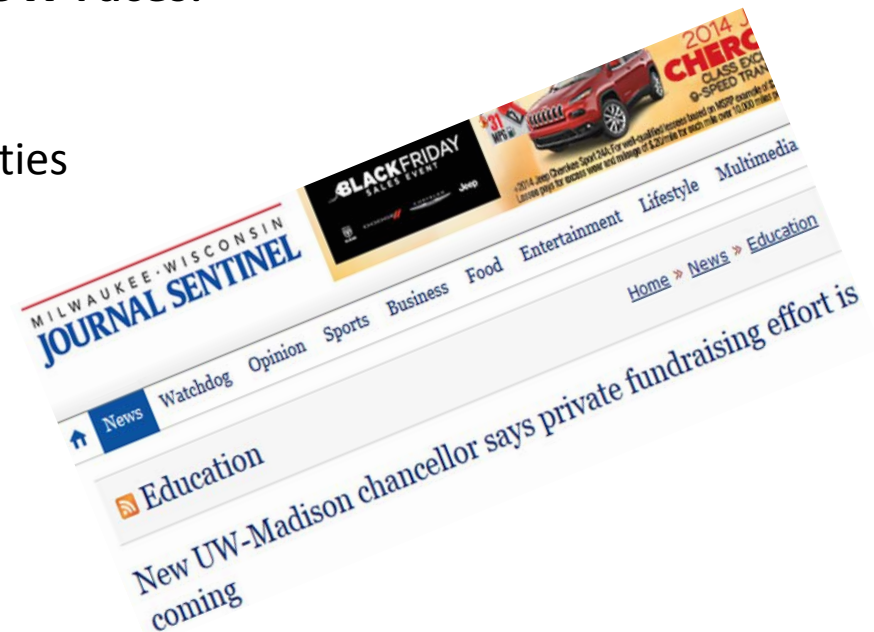
- Loss of Financial Support
- Potential Restrictions on Activities

- **Poor Financial Records**

- Transparency
- Financial Losses
- Misuse of Financial Resources
- Fraud
- Poor Decision Making
- Lack of Transparency
- Timeliness

- **Competitive Risk**

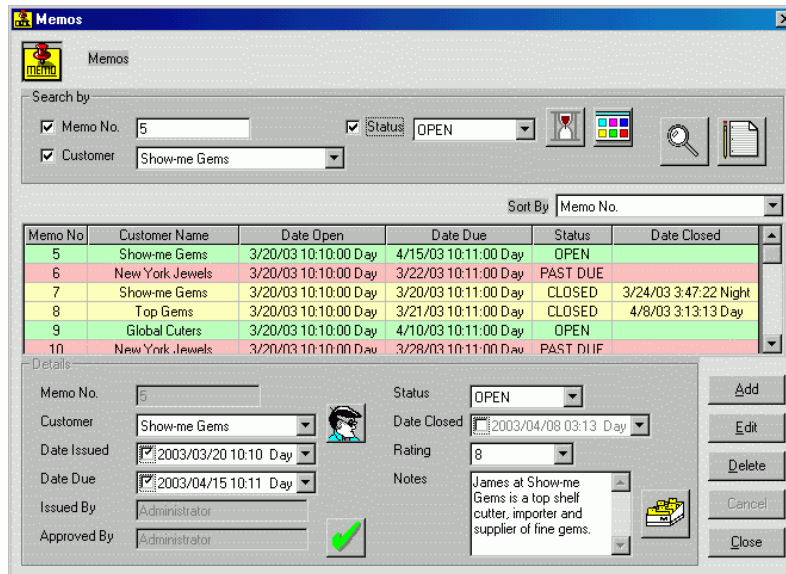
- New players
- Cost challenges



**CONTROLS EXIST TO
MITIGATE RISKS**

Good Internal Control ought to be Positive

- Example: Expense Reimbursement



As an Assistant Professor, it seemed to take longer to get an expense reimbursement than to get tenure.

Faster, more-user friendly, and better controlled

Internal Control

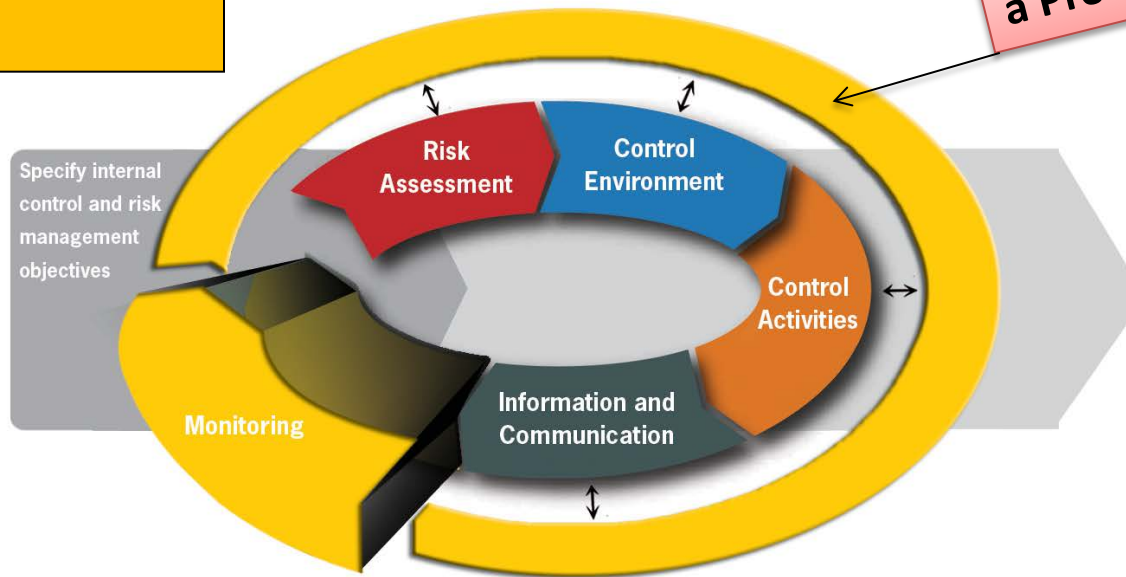
- **Internal control is a process** effected by the Board (Regents), Management (Chancellor and Deans) and other Personnel through processes, policies and procedures that an organization uses to:
 - **accomplish its goals and objectives,**
 - maintain **compliance** with laws and regulations,
 - ensure the **reliability** of information, including financial information, and
 - **protect its resources** both tangible (*e.g., equipment, property or funding*) and intangible (*e.g., reputation*).

My Challenge: Turning Principles into Positive Action

“Parenthetically, and closely related to this decision, is a fundamental premise that is often missed: **organizations should design internal controls to be cost-effective.** Developing and implementing effective internal controls should be no more of a burden than developing an effective quality control system over manufacturing. Some organizations may choose not to streamline controls (for more cost savings) because existing employees understand existing control processes (where changing may add costs). **The real decision is whether internal control, as part of a management process, effectively and efficiently achieves its objectives related to reporting, compliance, and operations.**” (p.4)

Internal Control as a Process

Applies to all 5
Components



Applies to all Internal Control
Objectives:
Operations,
Reporting,
Compliance

Concepts also apply to ERM:
But not specifically addressed

COSO Framework Update 2013

Environments changes...

...have driven Framework updates

Expectations for governance oversight

Globalization of markets and operations

Changes and greater complexity in business

Demands and complexities in laws, rules, regulations, and standards

Expectations for competencies and accountabilities

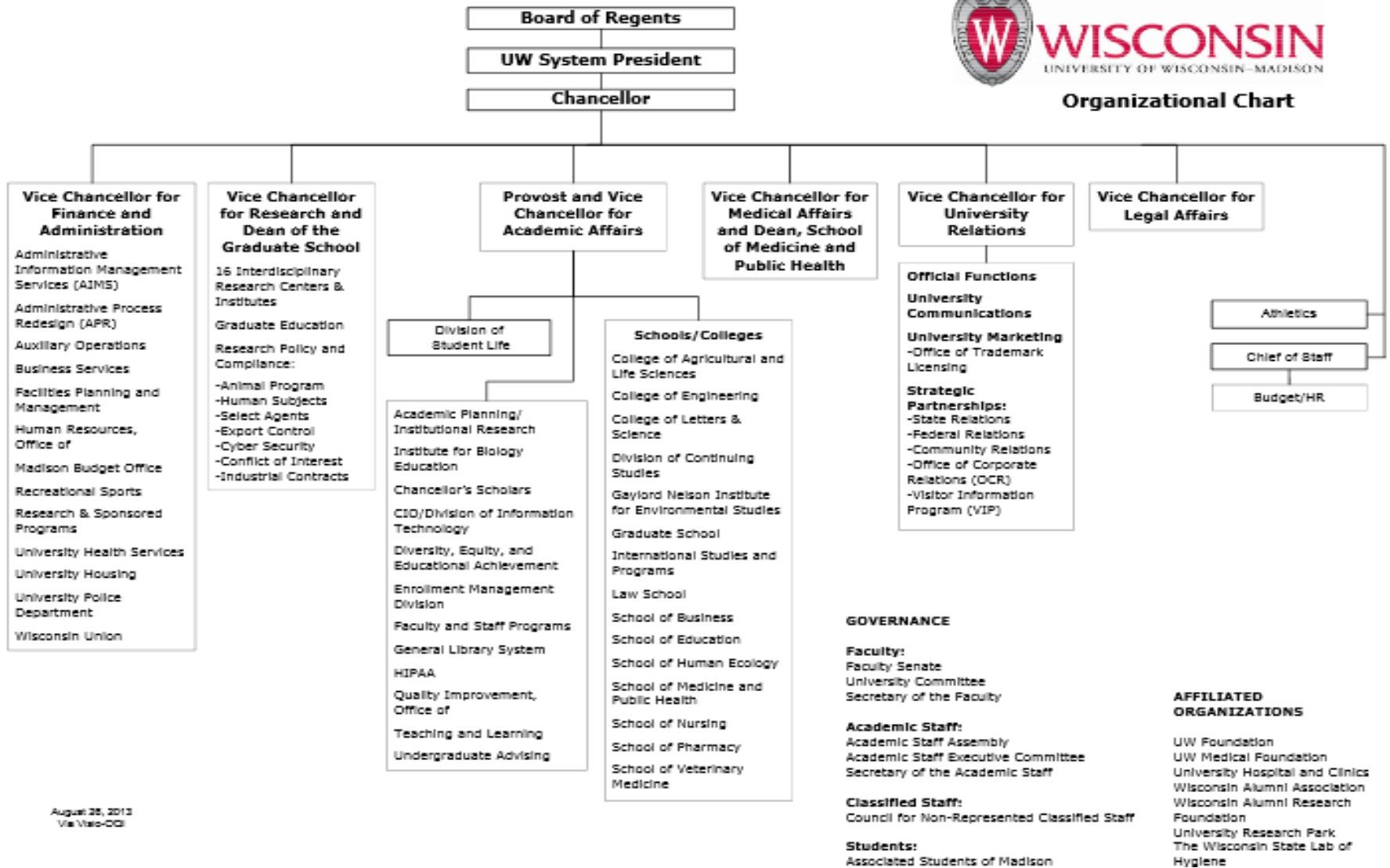
Use of, and reliance on, evolving technologies

Expectations relating to preventing and detecting fraud



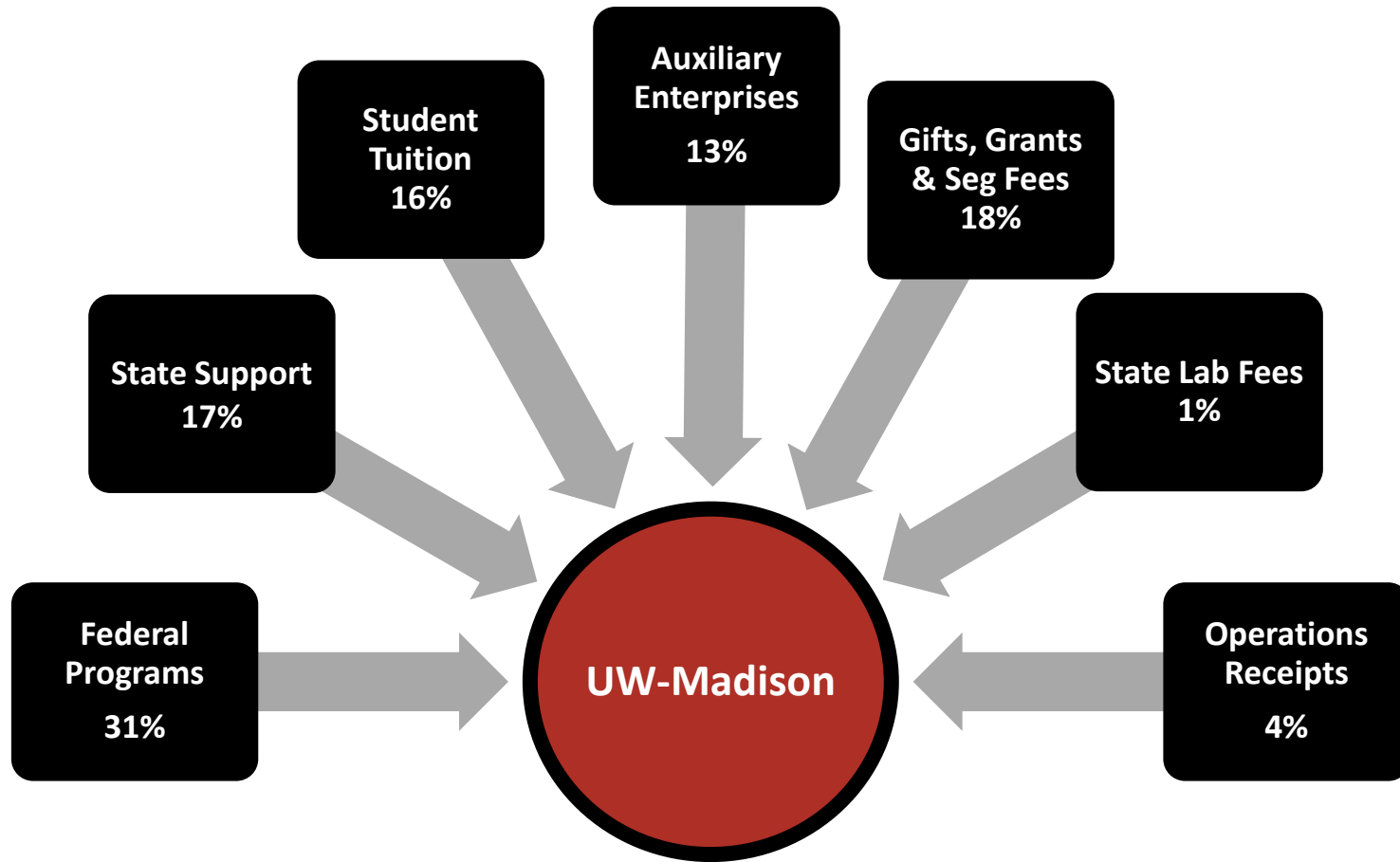
COSO Cube (2013 Edition)

We are a Complex Organization



August 26, 2013
Via Viteo-001

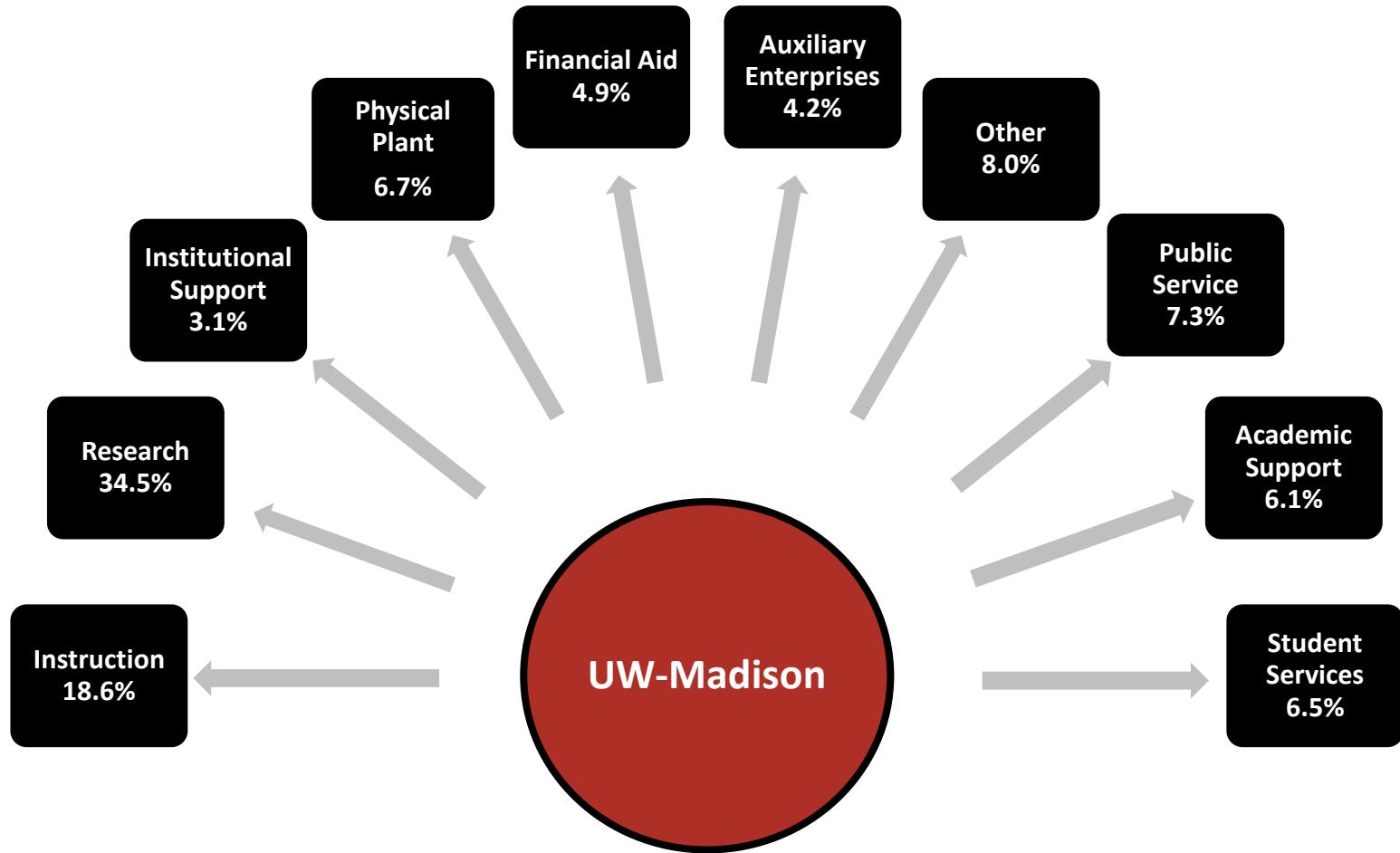
Multiple Funding Sources



Total = \$2,687,000,000

Source: UW-Madison Data Digest 2012-13

Supporting Many Needs



Total = \$2,433,200,000

Source: UW-Madison Data Digest 2012-13

However

- **That complexity is not Unique**
- **Every major U.S. Organization faces Similar Risks**
 - Must **compete** Globally with types of organizations that did not exist five years ago,
 - **Organizational Boundaries** become blurry
 - Former fully decentralized functions are often **centralized** to improve both Efficiency and Effectiveness
 - **Decision Making** can be decentralized, but within parameters
 - **Protecting Data** and Reputation is Important
 - Manual controls are integrated into I.T. and more emphasis is placed on developing effective **monitoring activities**.
 - **Reporting** starts with financial reporting, but is much broader.

COSO: Principles of Effective Internal Control

Control Environment

1. Demonstrates commitment to integrity and ethical values
2. Exercises oversight responsibility
3. Establishes structure, authority and responsibility
- 4. Demonstrates commitment to competence**
5. Enforces accountability

Risk Assessment

6. Specifies suitable objectives
7. Identifies and analyzes risk
- 8. Assesses fraud risk**
9. Identifies and analyzes significant change

Control Activities

10. Selects and develops control activities
11. Selects and develops general controls over technology
12. Deploys through policies and procedures

Information & Communication

13. Uses relevant information
14. Communicates internally
15. Communicates externally

Monitoring Activities

16. Conducts ongoing and/or separate evaluations
17. Evaluates and communicates deficiencies

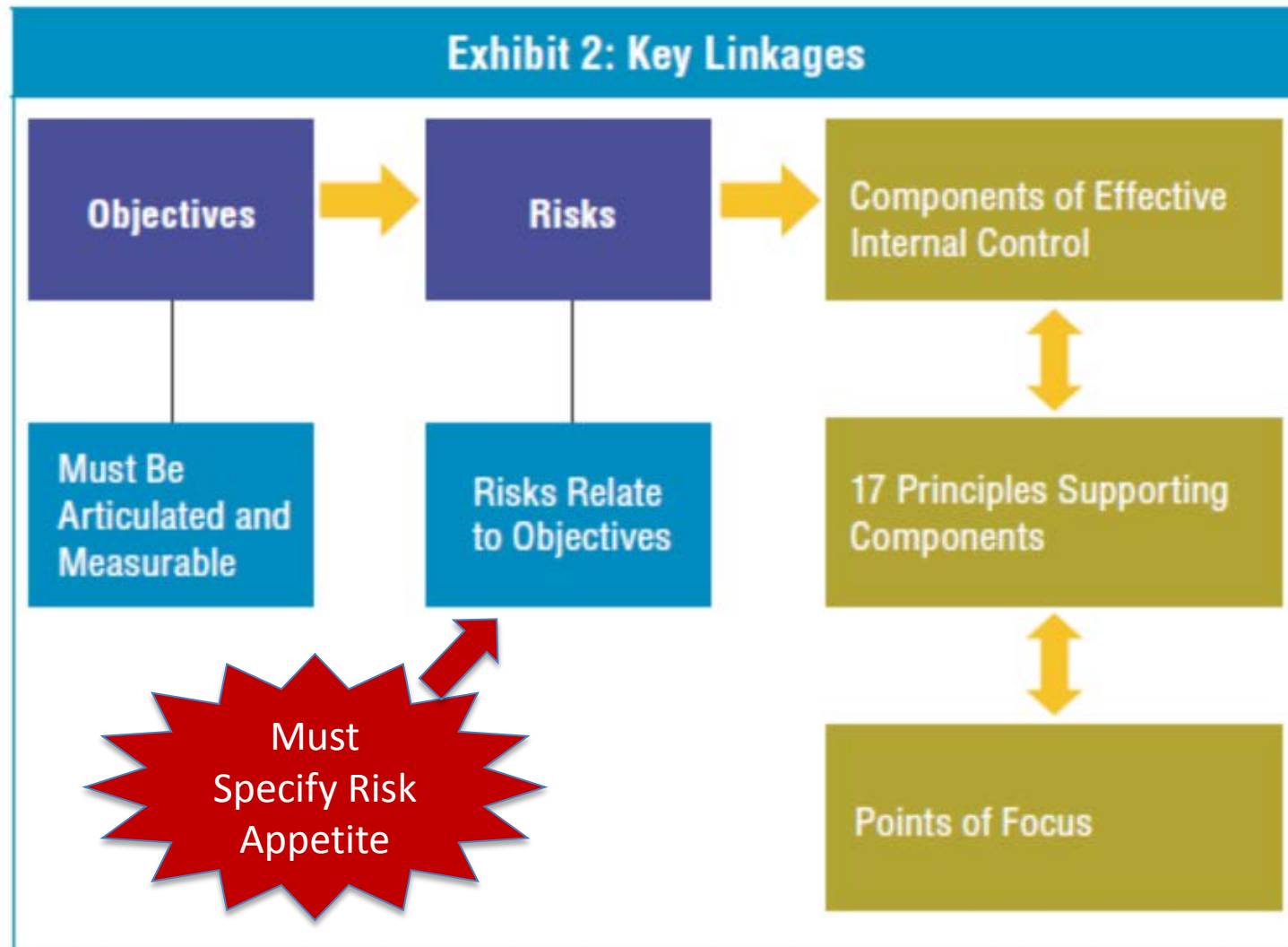
Internal Control is All About

Good Management

Achieving Objectives

Assigning Responsibility


Overview of Process





Example: Commitment to Integrity

- **Setting the Tone at the Top**
 - Actions
 - Communication
- **Establishing a Code of Conduct**
 - Articulate Values and Expectations
 - Communicate to enhance understanding
- **Evaluating adherence to the standards of conduct.**
 - Identify deviations
 - Communicate
- **Addressing Deviations in a Timely Manner**
 - Deviations are addressed
 - Problem is remedied
 - Actions are Communicated

Example of Control and Risk Analysis: Cash Handling

- In this example, assume that an Agricultural Extension Program is presented and traditionally participants can pay in advance or at the door with cash, check, or credit card.
- What are the **Objectives**?


Hint, think beyond cash to reporting, decision-making, Efficiency, Effectiveness
- *What are the Risks?*


Think beyond loss of cash to timeliness of reporting and decision making.
- What is the “Best Way” to **Mitigate** those Risks?


Consider a different approach, can technology help?
- **My question for you: Does it matter how all of this has been performed earlier? Are there ways that the process can be improved with different controls?**

Principles Related to Risk Assessment

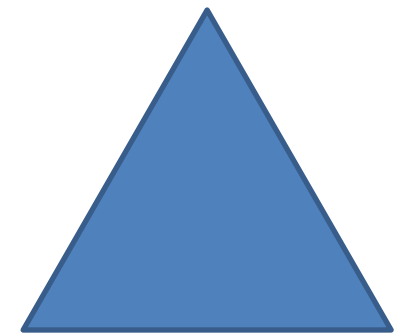
Risk Assessment

6. The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.
7. The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.
8. The organization considers the potential for fraud in assessing risks to the achievement of objectives.
9. The organization identifies and assesses changes that could significantly impact the system of internal control.

Fraud Points of Focus

- **Considers Various Types of Fraud**
 - More than financial fraud, include operational, compliance, including:
 - Fraudulent financial reporting
 - Fraudulent non-financial reporting
 - Misappropriation/Safeguarding of Assets
 - Illegal Acts and Corruption
- **Assesses Incentives and Pressures**
- **Assesses Opportunities**
- **Assesses Attitudes and Rationalizations**

Fraud Triangle



A Real Life Experience: More Assurance, Less Cost

**My Challenge to the CAE, External Auditor, CFO, and Controller:
Take 1,800 hrs. out of Control Testing.**

- **Start with Processes and Risk**
- **Focus on IT controls to identify opportunities for efficiency**
 - How does IT Provide Support that its controls are working.
 - Can IT facilitate Continuous Monitoring?
- **Work with Controller, Department Heads (process owners) and External Auditors**
 - Leadership from Controller Department
 - **Process Owners were Actively Involved in Every Step**
 - Areas where Internal and External Audit work together, example Walkthroughs
- **Systematic Process on what Controls Ought to be Tested**
- **Analyze Work Performed by Outsourcing Partners**

Approach

- Ownership and Leadership from the Controller, key process owners, with a Key Leader from Internal Audit
- External Auditor shared a template of Risk Associated with Various Transaction Cycles
- All Divisional Controllers were Actively Involved and Took Ownership



Objectives

Risks

Key Controls

Was it worth the Investment?

A Strong Yes

SOX Metrics Dashboard – Controls and Testing

	Actual FY 2012	Planned FY 2013	Difference	% Difference
Total Key Controls (*)	396	181	(173)	(49%)
Testing Samples (**)	2,448	730	(1,718)	(70%)

Total processes for Walkthroughs went from >80 to 12 due to centralization and I.T. controls.

Assessment

- All Components of the Framework must be **Present** and **Functioning**
- **Points of Focus** provides an approach to facilitate the assessment.
- **Deficiency** definitions re consistent with professional guidance
- **Bottom Line:** are the internal controls, working together, sufficient to provide high assurance that material misstatements in financial statements will not occur, or similar statements for operations and compliance objectives.

University of Wisconsin: Steps Taken to Date

- Identification of a **Strong Project Leadership Team** Across Campus in Planning this forum.
- **Leadership Team** will be in place to assist in the financial planning process and to consider **integration across campus**
- **Advisory Team Established**
 - Fiscal leadership with outside consultant partner firm
 - Focus on common terminology and processes
 - Well-versed at integrating I.T.
 - Understand this is an across-campus partnership
 - Experienced in Risk Assessment and Key Control Identification
 - Not a “Check the Box” Approach
- **Leadership of Campus Governance and Business Services** to find cost effective and efficient ways to assist you.

Goals are Realistic

- **Improved Integrity of financial information** with comprehensive financial reporting capabilities
- **Comprehensive internal control framework/plan** is implemented across campus
 - Assets protected
 - Efficiencies identified
 - Reputation Protected
 - Processes Improved
 - Processes to ensure Compliance with all Major Grants/Donations

Embrace Change: Steps for UW

1. Commit to Active **Participation** – and leadership across the organization.
2. Develop an **Actionable Plan** with Objectives, Risk Analysis, and Measurable Goals.
3. **Build on Expertise** and relationship of (a) organizational objectives, (b) risk management, and (c) internal control



You will be asked what role to you want to play in accomplishing these objectives.



UW-Madison Environment

Dan Langer, CPA

Controller and Director of Accounting Services

University of Wisconsin-Madison

February 25, 2014

Internal Control

- UW System and the Universities have Delegated Authority from the State
- Entities Required to Certify Every Three Years in accordance with State Statute
- UW-Madison is Financially Complex, Large and Decentralized
- Necessitates an Engaged Process with Dean's, Directors, Fiscal Officers and their Teams

Disbursement Facts

- \$700 Million in Supplies and Services
- 150,000 Invoices per year
- 2,000 Procurement Cards
- 1,000 Corporate Cards

Capital Equipment = Items Over \$5,000

- Inventory Field Work began December 2013
- 255 Department Property Administrators Involved
- Retagged All Capital Equipment
- Looking for:
 - 33,700 Items
 - \$720 Million Gross Book Value
 - \$129 Million Net Book Value
- Over 90% of the Net Book Value Found to Date

Managed Travel Program

- Travel Advisory Group including Faculty and Travel Arrangers
- UW Madison Travel Spend
 - ~ \$25 Million Total
 - ~ \$12 Million Airfare Alone
- New Vendor Contract with Fox World Travel and Concur
 - Activity increased to over 35% of all air travel from 10% and still growing
 - Primary Vendor for Non-complex Travel

Improvement Opportunities



1. Variety of Cash Handling Practices

- Approximately \$45 million of flow per week

2. Financial Resources

- Approximately 400 Financial Related Positions
- Sufficient depth of resources
- Training and development

3. System Security

4. Consistent and Quality Financial Information for Decision Making

- WISDM
- WISDM to Excel
- Hyperion Queries
- Campus Access for UW Foundation
- Great Plains
- Oracle One World
- PeopleSoft
- 3270 Budget System
- Etc.????



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Internal Controls at Indiana University

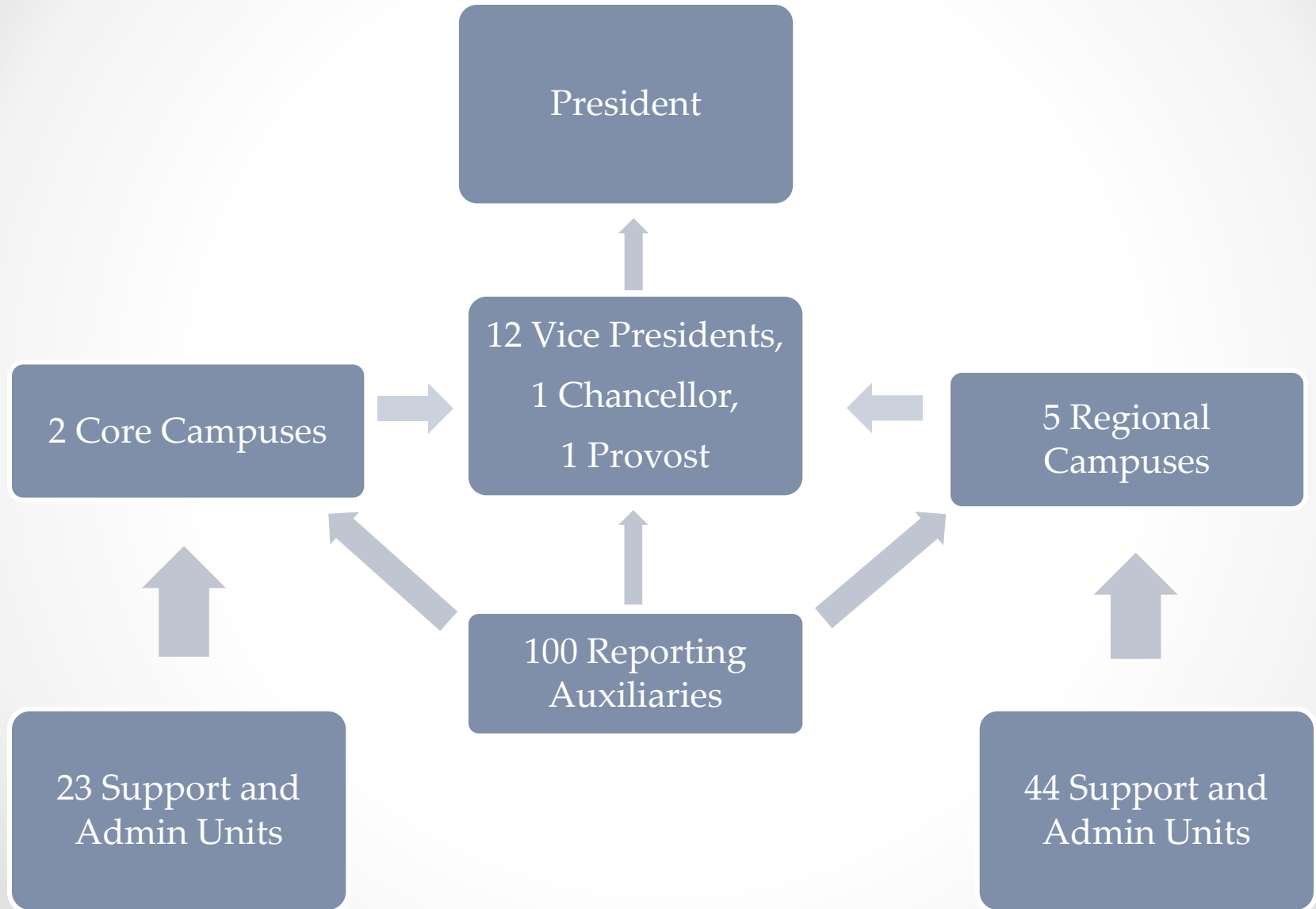
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Evolution of Internal Controls at IU

- Where we were
- Where we are now
- How we got there
- Where we need to go

IU Structure




Evolution of Internal Controls at IU

Corporate Scandals



Sarbanes-Oxley

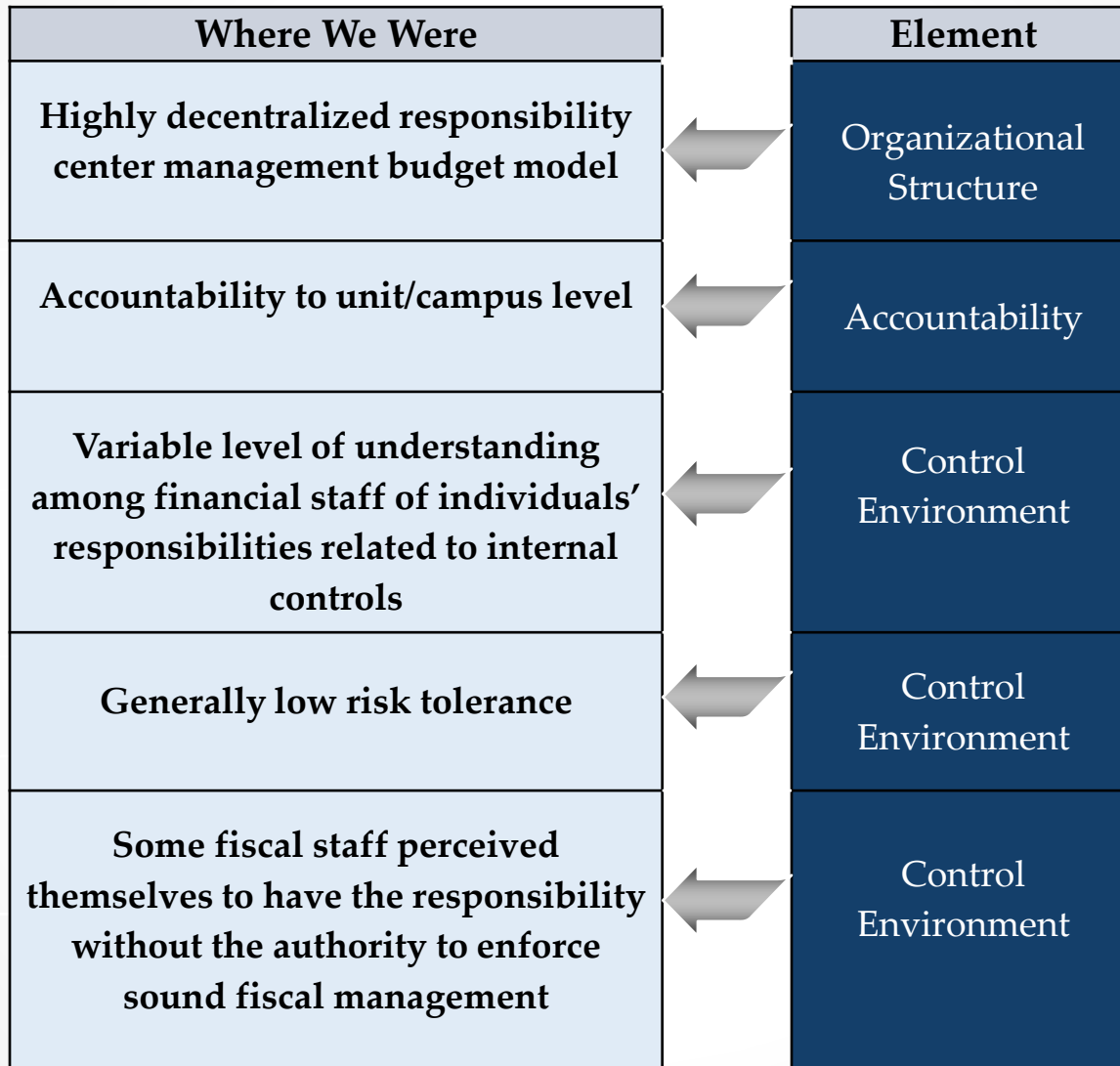


PWC Risk Assessment of Financial Internal Controls

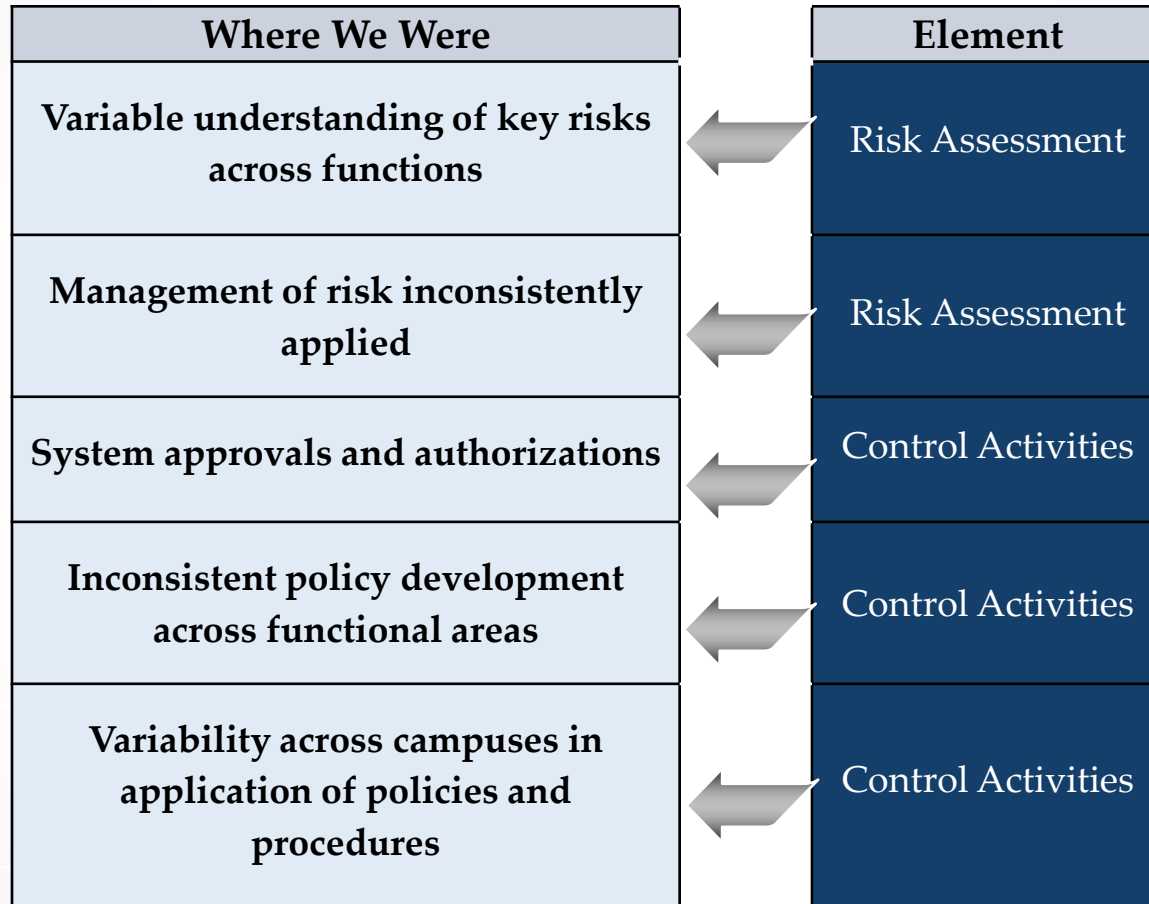


Sub-certifications, Fiscal Officer Training, Policies, Ongoing Risk Assessments, Reporting Hotline

Internal Controls at Indiana University



Internal Controls at Indiana University



Sub-certification

- PWC recommendation
- Two-way communication tool adapted to decentralized structure

Sub-certification

- Form and content
- Implementation process
- Distribution
- Example disclosures

Assertion Excerpts

“I confirm, to the best of my knowledge and belief, the following representations:

- 1. Our financial reports include all properly classified financial transactions of our organization.*
- 2. We acknowledge responsibility for the adoption and implementation of university financial policies, and the establishment and maintenance of an internal control structure and procedures.*
- 3. There have been no undisclosed instances of fraudulent financial transactions or misappropriations of assets within our organization.”*

Example Disclosures – Compliance Issues

- *“FMS Tax determined in late April 2007 that [Department X] should charge sales tax for products [XYZ]. [Department X] implemented collection of sales tax on 8/27/07”*
- *“In late July discovered that [X] Center applied for a grant without going through Sponsored Research. I contacted and met with Sponsored Research and assured them we would meet with [X] Center and review the guidelines for grant applications. Met with [X] Center director. They will go through proper channels (grant ended up not being funded after all).”*

Example Disclosures – Policy Issues

- *“All [School of Y] faculty sign a conflict of interest form. However, there is no formal measurement for professional and support staff. A school task force is being assigned to put in place a measurement for staff. The interest is to start the measurement in FY08.”*
- *“We have no staff conflict of commitment to the best of our knowledge. However we are uncomfortable signing the statement since the Campus and [School of Z] have no procedure in place to verify.”*

Example Disclosures - Control Activities

- *“School of [XYZ] has worked closely with the campus to ensure segregation of duties and other appropriate internal control measures are in place in School of [XYZ]. School of [XYZ] is in the process of implementing new revenue processing procedures which should minimize the risk of theft or fraud in this area.”*

Example Disclosures – Communication Issues

- *“We acknowledge we are responsible for the accuracy of the financial statements of our organization to the extent we have control of the procedure for processing the transactions. The student fee income reported on our financial statements is not controlled by us. We have only limited access to reports for verification of the student income fed into our Statement of Account, thus the attestation of the accuracy and the responsibility of internal controls associated with the accuracy of the stated student fee income is excluded from this certification.”*
- *“The campus has not been in the same position to provide input on policy questions as we were prior to the Purchasing centralization. We are continuing to work to improve the communication flow to ensure adequate review/approval by the campus.”*

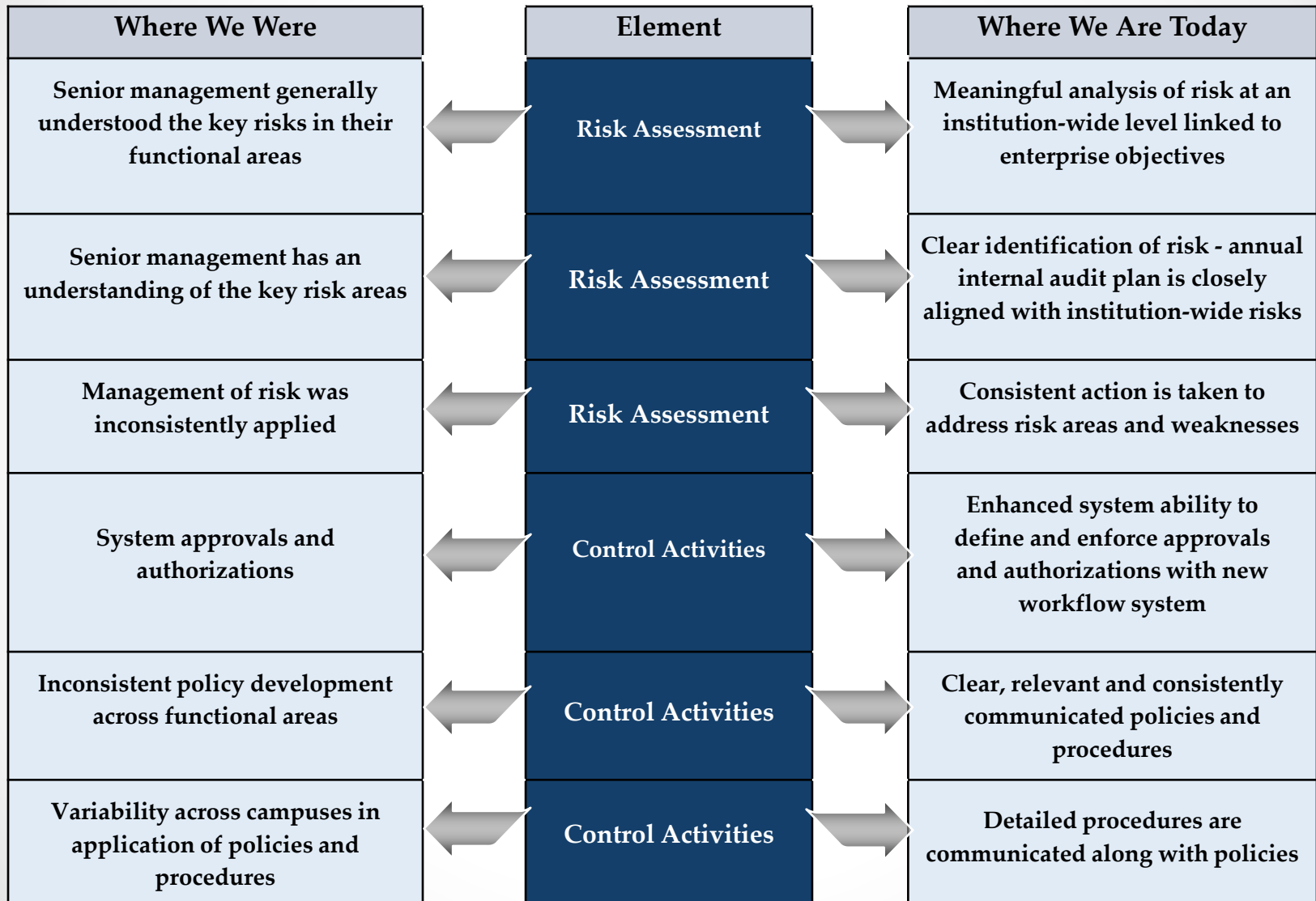
Example Disclosures – More Than We Asked For

- *“A \$34,031 amount payable to [XYZ] University for the cost of jointly taught classes at their [ZYX] Center was not recorded at year end.”*
- *“Eight cash deposits from the garages totaling \$4,256.35 disappeared in May. IUPD and Internal Audit were notified and conducted investigations. The money has not been returned but procedures have been changed and the matter is considered inactive.”*
- *“We did have some stolen items; these were properly reported to Risk Management and IU Police.”*
- *“Shortage of \$20.00 discovered in revolving fund – replaced in accordance with revolving fund agreement.”*
- *“Photo had an additional repair charge of \$320.81 from Fuji film that came in late in July 2009 that belongs to April of 2009 (FIS document # FB3751910).”*

Internal Controls at Indiana University

Where We Were	Element	Where We Are Today
Highly decentralized responsibility center management budget model	Organizational Structure	Highly decentralized responsibility center management budget model
Accountability to unit/campus level	Accountability	Explicit two-way communication between central and campus/unit levels control is everyone's responsibility
Variable level of understanding among financial staff of individuals' responsibilities related to internal controls	Control Environment	Pervasive understanding among financial personnel of the importance of individuals' responsibilities related to internal controls
Generally low risk tolerance	Control Environment	Low risk tolerance is widely acknowledged and applied by administrators throughout the institution
Some fiscal staff perceived themselves to have the responsibility without the authority to enforce sound fiscal management	Control Environment	Clearly defined authority and responsibility - mistakes and escalation are handled in a way that encourages communication

Internal Controls at Indiana University



Next Steps

- More dialogue with units
- Reduced accounting focus → more business process area focus
- Built-in follow-up process
- Metrics
- Confidence scale



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Internal Control Research Summary

Karla Johnstone, EY Professor of Accounting
University of Wisconsin-Madison
School of Business

February 25, 2014

Benefits of Strong Internal Controls

- Risk assessment processes help the organization identify and prioritize risks that it faces.
- Identifying key controls ensures that the organization devotes monitoring resources where they can provide the most value.
- Routine monitoring makes it more likely that control failures are detected early.
- Good controls yield more accurate and reliable financial reporting and better data for decision making.
- Good controls yield a lower likelihood of monetary or property theft by individuals inside or outside the organization.

Consequences of Weak Internal Controls

- Organizations with material weaknesses in internal controls have the following attributes:
 - Lower credit ratings, so higher cost of credit*
 - Lower profitability and lower cash flows from operations*
 - Greater debt loads*
 - Greater risk of financial failure
 - Greater risk of a financial misstatement
 - Theft or misuse of organizational assets
 - Higher external audit fees
 - Weak indicators of corporate governance (e.g., poorly performing boards and audit committees)
 - High turnover of top executives
 - Reputation loss

**indicates not applicable in university setting*

My Research on Internal Controls

- Hoitash, Hoitash, & Johnstone
 - *“Internal control material weaknesses and CFO compensation”*
 - Shows that CFO compensation declines when an internal control weakness is discovered.
 - This “penalty” is greatest when corporate governance of the organization is stronger.
- Johnstone, Li, & Rupley
 - *“Changes in corporate governance associated with the revelation of internal control material weaknesses and their subsequent remediation”*
 - Describes how organizations respond to crises, such as the revelation of an internal control material weakness.
 - Top management, board of directors, and audit committee members are often fired upon such revelations.
 - Remediation (fixing) the problem is associated with improvements in corporate governance, including members of the board and audit committee.



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Afternoon Agenda

1:00 p.m. - 1:15 p.m. Introduction

1:15 p.m. - 1:25 p.m. Attendees move to Session 1 Table

1:25 p.m. - 2:05 p.m. **Session 1 (40 minutes)**

2:05 p.m. - 2:15 p.m. Attendees move to Session 2 Table

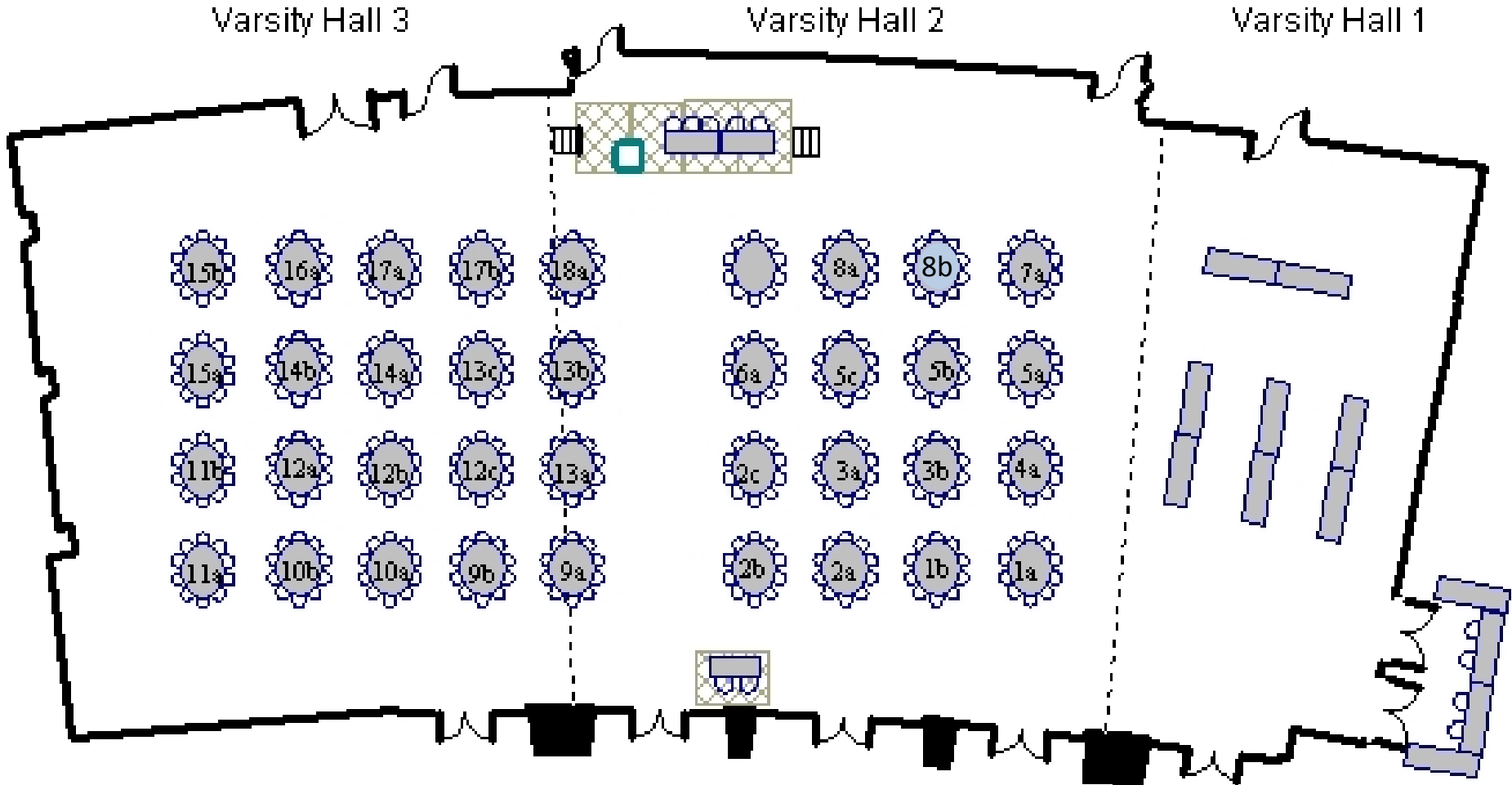
2:15 p.m. - 2:45 p.m. **Session 2 (30 minutes)**

2:45 p.m. - 2:50 p.m. Attendees move to Session 3 Table

2:50 p.m. - 3:20 p.m. **Session 3 (30 minutes)**

3:20 p.m. - 3:30 p.m. Afternoon wrap-up

Table Locations for Financial Services Break-Out Sessions



The Questions That Will Be Addressed

Session 1
40 mins

- A. Describe examples of current processes that we should retain and, as needed, build upon.
- B. Are there things you would like to change in your area and/or start doing immediately?

Session 2
30 mins

- C. What would help you (or would you need) to improve/makes things better in your unit?

Session 3
30 mins

- D. Where do you see potential internal control weaknesses in your area and across campus?

Session 1 Questions

- Describe examples of current processes that we should retain and, as needed, build upon.
- Are there things you would like to change in your area and/or start doing immediately?

Session 2 Question

- What would help you (or would you need) to improve/makes things better in your unit?

Session 3 Question

- Where do you see potential internal control weaknesses in your area and across campus?



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