

SUBSIDIARY LEDGER INTERNAL CONTROLS DEFINITIONS & EXPECTATIONS:

Introduction:

Due to the technological limitations of the University's purchasing and record keeping systems, as well as the decentralized University environment, there are limited preventative (or "front-end") internal controls with respect to the processing of revenue and expenditure transactions initiated by departments. Furthermore, there is no single internal control that would detect unauthorized and inappropriate transactions at the "back-end" within the initiating departments, but rather a set of controls working together to achieve control / mitigate risk to appropriate levels. Therefore, a critical component of the University's internal control environment over financial transactions is the departmental subsidiary ledger control activities for reviewing and validating transactions posted to the FRS ledgers.

While performing the current horizontal audits of various transactions initiated by departments, OUA became aware that there was an inconsistent understanding of definitions and expectations among departments with respect to the key subsidiary ledger internal controls of Ledger Reconciliation, Ledger Review and P&L and Budget Review. To overcome this gap, OUA facilitated the creation of this document with the input and assistance of the initiating departments that participated in the horizontal audits.

The purpose of this document is to:

- 1) Define key internal control terminology.
- 2) Recommend internal control procedures for subsidiary ledger management.
- 3) Provide detailed written guidance for all departments and sub-units regarding subsidiary ledger internal control procedures.

The focus of this document is on the below three internal controls, which are designed to work in conjunction in order to provide an effective internal control environment over subsidiary ledgers and to support sound business practices and fiscal management.

SUBSIDIARY LEDGER RECONCILIATION

A Subsidiary Ledger Reconciliation is an internal control activity where the line items within the monthly subsidiary ledger are agreed to the respective supporting documentation.

- This includes reconciling revenue and expense (including payroll) sub codes.
- In addition to agreeing dollar amounts and descriptions to supporting documentation, a Subsidiary Ledger Reconciliation also involves reviewing the transactions for appropriateness and reasonableness.
- A follow-up on discrepancies is also performed.
- The individual performing the reconciliation is referred to as the “Preparer”.

SUBSIDIARY LEDGER REVIEW

A Subsidiary Ledger Review is a 2-step internal control activity performed by an individual referred to as the “Reviewer” that includes:

- 1) Review of the work performed by the Preparer to verify that the reconciliation(s) was properly and accurately completed.
- 2) Review of the detailed transactions within a monthly subsidiary ledger account by a person who is knowledgeable of the area and who can objectively and effectively analyze the transaction data for reasonableness. The Reviewer should also research any potential discrepancies, such as unrecognized or unusual payments that are not adequately justified / explained by the documentation provided by the Preparer of the reconciliation.

P&L and BUDGET REPORT REVIEW

A P&L and Budget Report Review is an internal control activity that includes an overall assessment of the financial position related to a specific subsidiary ledger account. This analysis generally includes a comparison of actual to budget for all revenue and expense (including payroll) sub codes. Large and/or unusual variances are investigated and explained.

Subsidiary Ledger Internal Control Definitions and Expectations

I. General Definitions:

Subsidiary Ledger Accounts:

Subsidiary Ledger accounts are those accounts that begin with 1 through 9.

Internal Controls:

An organization's methods, systems and procedures for (1) protecting resources from waste, loss, theft or misuse (2) ensuring that resources are used in accordance with law and donor intent and (3) producing reliable financial statements based on accurate and verifiable data.

Preventative Controls

Internal Control activities designed to provide reasonable assurance that errors, abuse and fraud will be prevented.

Detective Controls

Internal Control activities designed to provide reasonable assurance that errors, abuse and fraud will be detected in a timely manner.

Segregation of Duties:

Segregation of duties is a basic, key internal control. It is used to ensure that errors or irregularities are prevented or detected on a timely basis by employees in the normal course of business. The four functions that should be performed by separate individuals are authorization, custody, record keeping, and reconciliation. No one person should have control over two or more of these responsibilities.

Risk Assessment:

An analysis that determines the possibility of an event occurring that will have an impact on the achievement of objectives. Risk is measured in terms of impact and likelihood. Risks that are ranked high should be mitigated by internal controls.

Cost-Benefit Analysis:

Weighing the total expected cost of a risk mitigation internal control activity against the total expected benefits of the activity in order to choose the best or most effective risk mitigation internal control strategy.

Supporting Documentation:

Purchase requisitions, invoices, receipts, packaging slips, purchase orders, contracts, written notes/memos and other paper work that provide evidence of the validity and appropriateness of an organization's financial transactions. Supporting documentation should always be self-explanatory and not require verbal explanation.

II. Subsidiary Ledger Internal Control Expectations:

Key Risk Criteria Considered:

- Financial/Regulatory/Reputational/Strategic: A subsidiary ledger internal control process that lacks a detailed reconciliation of line items and the independent and objective oversight and review by senior department management creates opportunity for errors, misuse and fraud. An inadequate ledger reconciliation and review process has been cited as one of the root causes of most University fraud cases.

- Note: The expectations and recommendations for subsidiary ledger internal controls are proven to be effective measures; however, they cannot be relied on to prevent all instances of errors, misuse, or fraud. The recommended internal control activities are detective in nature and are designed to provide reasonable assurance that errors, misuse and fraud will be detected in a timely manner.

Document Scope:

The following describes University Audit's expectations and recommendations related to departmental level subsidiary ledger internal control activity. The controls discussed are:

- 1) Subsidiary Ledger Reconciliation,
- 2) Subsidiary Ledger Review, and
- 3) P&L and Budget Report Review.

All Inclusive Perspective:

This document describes University Audit's expectations for proper internal controls over all ledgers, including ledger 5 (Sponsored Programs). However, this document does not replace or override documented guidelines provided by ORPA, ORACS or CLASP. This document is complementary to the existing guidelines and is meant to provide an all inclusive explanation of subsidiary ledger internal control processes from an audit prospective.

Refer to ORPA's Toolbox for Administrators, "Monthly Things to Remember Practice Aid"
<http://www.rochester.edu/ORPA/resource/administrators/MonthlyChecklist.pdf>

Appendix A: Ledger Controls Self-Analysis Worksheet Template

Refer to Appendix A for a template to be used to assist in reviewing and documenting a department's processes.

Appendix B: University Practices

Refer to Appendix B for list of ledger reconciliation practices performed by various University departments and functions.

1) **Subsidiary Ledger Reconciliation:**

Definition:

A Subsidiary Ledger Reconciliation is an internal control activity where the line items within the monthly subsidiary ledger reports are agreed to the respective supporting documentation.

- This includes reconciling revenue and expense (including payroll) sub codes.
- In addition to agreeing dollar amounts and descriptions to supporting documentation, a Subsidiary Ledger Reconciliation also involves reviewing the transactions for appropriateness and reasonableness.
 - I. Appropriateness and reasonableness can be evaluated by being mindful of the department's business operations and financial matters and asking:
 - Does the nature of the charges make sense based on the services the department provides and the types of expenses normally incurred?
 - Do the payment amounts make sense based on the services provided or the items purchased?
 - Do you recognize the vendors as businesses that have provided goods and/or services in the past?
 - Do payments to employees seem consistent with their duties?
 - Does the frequency of payments to vendors, individuals or employees seem consistent with expectations?
- A follow-up on discrepancies is also performed.
- The individual performing the reconciliation is referred to as the "Preparer".

Minimum Expectation:

University Audit expects, at a minimum, that all departments have a formal process that ensures all monthly subsidiary ledgers are reconciled on a timely basis.

- The level to which the subsidiary ledgers are reconciled should be cost-beneficial and commensurate with the level of assessed risk (i.e., Risk Assessment).
- If reconciling less than 100% (the "Ideal"), the method for reconciling should be formally documented to fully describe the department's process for selecting the items that will be reconciled; (sampling, dollar amount thresholds, risk based, etc). Additionally, a monitoring process should be implemented by management to periodically review the risk criteria for determining the sample items to be included in the ledger reconciliations and for measuring the effectiveness of the ledger reconciliations.
- The Department Chair/Director/Dean/VP should acknowledge the acceptance of risk associated with any process that does not meet the Ideal Expectation discussed below.
- Note: for sponsored research accounts, the minimum expectation is that all transactions will be reconciled on a monthly basis. Refer to the guidance provided by ORPA, ORACS and CLASP for further details.

Ideal Expectation:

The ideal practice is that a Subsidiary Ledger Reconciliation is performed monthly for every subsidiary ledger account.

- All transactions are reconciled to supporting documents for all revenue and expense (including payroll) line items.
- The reconciliation should be performed by an employee who is knowledgeable of the business practices and financial matters, such as an Administrator or Financial Analyst.
- A list or file is maintained for pending ledger corrections. The list or file is referred to monthly to ensure requested adjustments have been posted
- The reconciliation should be performed with appropriate consideration of proper segregation of duties: Where possible, the Preparer should not also have custody, authorization or record keeping duties. If proper segregation of duties is not achievable, a

greater level of management oversight and involvement in the Ledger Review internal control (see #2) is required.

2) *Subsidiary Ledger Review:*

Definition:

A Subsidiary Ledger Review is a 2-step internal control activity performed by an individual referred to as the "Reviewer" that includes:

- 1) Review of the work performed by the Preparer to verify that the reconciliation(s) was properly and accurately completed.
- 2) Review of the detailed transactions within a monthly subsidiary ledger account by a person who is knowledgeable of the area and who can objectively and effectively analyze the transaction data for reasonableness. The Reviewer should also research any potential discrepancies, such as unrecognized or unusual payments that are not adequately justified / explained by the documentation provided by the Preparer of the reconciliation.

Minimum Expectation:

University Audit expects, at a minimum, that all departments have a formal process that ensures all monthly subsidiary ledgers are reviewed on a timely basis.

- A Subsidiary Ledger Review should be performed after the Subsidiary Ledger Reconciliation is complete.
- The Ledger Review should not be performed by the same person that performs the Ledger Reconciliation.
- Reconciliations completed by the Preparer are reviewed by a secondary individual (the Reviewer) to verify that the reconciliations were properly and accurately completed.
- The secondary individual performs a cursory review of all transactions listed on the detailed Subsidiary Ledger with particular attention to any high-risk, unusual, and unrecognized items.
- The secondary individual should be an employee who is knowledgeable of the department's financial and business matters.
- For Ledger 5 accounts, the PI should be performing the Ledger Review and signing a monthly PI Sign off Form.
- The Department Chair/Director/Dean/VP should acknowledge the acceptance of risk associated with any process that does not meet the Ideal Expectation discussed below.

Ideal Expectation:

The control items listed above under minimum expectations are performed by the Chair/Director/Dean/VP on a monthly basis.

- In addition to following-up on discrepancies, the ledger Reviewer would select a sample of transactions every month and investigate them further to validate the accuracy and appropriateness of the transaction. The criteria for making a selection of transactions to further inspect should be risk-based, such as an unusual payee/vendor, an unrecognized individual, a transaction that resulted in a cash distribution.

3) P&L and Budget Report Review:

Definition

A P&L and Budget Report Review is an internal control activity that includes an overall assessment of the financial position related to a specific subsidiary ledger account. This analysis generally includes a comparison of actual to budget for all revenue and expense (including payroll) sub codes. Large and/or unusual variances are investigated and explained.

Minimum Expectation:

University Audit expects, at a minimum, that all departments have a formal process that ensures all monthly subsidiary ledgers are reviewed from a high-level financial viewpoint by the individual who is fiscally responsible for the subsidiary ledger account; generally this is the Chair, Director, Dean, VP or PI.

Ideal

Budgets are established for all relevant sub-codes. Spreadsheets are maintained to record and monitor actual monthly amounts (categorically by sub code) and to compare them to the established budgets. Monthly and annual trends are analyzed (graphs, charts, etc) and discrepancies are investigated. Deficit sub codes, or those sub codes approaching deficit, should be immediately investigated. Findings, conclusions, and actions plans are documented. The use of a shadow accounting / encumbrance system (Miser/UR-GEMS, QuickBooks, spreadsheets, etc) also helps manage and monitor the department's finances. A shadow accounting system or encumbrance system provides for an accrual basis to account for transactions that have been initiated by the department, but have not yet been processed by Central Finance (and therefore have not been posted to the ledgers).

4) Evidence

The completion of the ledger control activities (Ledger Review, Ledger Reconciliation and P&L & Budget Report Review) should be documented by sign-off and dating on the ledger or report. Ideally, the Department should create a sign-off form that evidences that the ledger control activities have been completed (name, title, signature and date).

Sign-off forms provide the best-documented evidence that the ledger control activities are complete. Sign-off sheets should include a space for the signature and date of the individual who completed the Ledger Reconciliation and the individual who performed the Ledger Review (which includes a review of the reconciliation). The form could also have a place for the signature and date of the individual that performed the P&L & Budget Report Review. The Sign-off Form should have a brief description of the assertion being confirmed by each signature. A place to document open issues, questions and exceptions should also be included on the form. Sign-off forms should be retained in a central location.

APPENDIX A: Ledger Controls Self-Analysis Worksheet Template

Dept	Ledger # / Account #	Subsidiary Ledger Reconciliation performed? (yes/No)	Performed by (Name, Title)*	Subsidiary Ledger Secondary Review performed? (Yes/No)	Performed by (Name, Title)*	Financial Reports reviewed by Chair/Dean/ Director/VP ? (Yes/No)
A	Ledg 1 Acct# xxx					
	Ledg 1 Acct# xxx					
	Ledg 2 Acct# xxx					
	Ledg 2 Acct# xxx					
	Ledg 3 Acct# xxx					
	Ledg 3 Acct# xxx					
	Ledg 4 Acct# xxx					
	Ledg 4 Acct# xxx					
	Ledg 5 Acct# xxx					
	Ledg 5 Acct# xxx					
	Ledg 6 Acct# xxx					
	Ledg 6 Acct# xxx					
	Ledg 7 Acct# xxx					
	Ledg 7 Acct# xxx					
	Ledg 9 Acct# xxx					
Ledg 9 Acct# xxx						
B	Ledg 1 Acct# xxx					
	Ledg 1 Acct# xxx					
	Ledg 2 Acct# xxx					
	Ledg 2 Acct# xxx					
	Ledg 3 Acct# xxx					
	Ledg 3 Acct# xxx					
	Ledg 4 Acct# xxx					
	Ledg 4 Acct# xxx					
	Ledg 5 Acct# xxx					
	Ledg 5 Acct# xxx					
	Ledg 6 Acct# xxx					
	Ledg 6 Acct# xxx					
	Ledg 7 Acct# xxx					
	Ledg 7 Acct# xxx					
	Ledg 9 Acct# xxx					
Ledg 9 Acct# xxx						

* Segregation of Duties concepts must be considered.

APPENDIX B: UNIVERSITY OF ROCHESTER LEDGER RECONCILIATION PRACTICES:

ONLINE REQUEST & ELECTRONIC LEDGER COMPARE MANUAL LEDGER COMPARE (Laser Lab)	ELECTRONIC LEDGER COMPARE (Rush Rhees Library)	MANUAL LEDGER COMPARE WITH EXCEL LIST (Other Departments)	MANUAL LEDGER COMPARE (Other Departments)
--RFP purchase entered into online system -- RFP form automatically prints --Electronic version of the ledger obtained --Electronic comparison of RFP data to ledger --Reports are created showing exceptions/non-matches --Requires ACCESS databases, electronic version of the ledger, IT support.	--RFP purchase manually entered into a database or file --Electronic version of the ledger obtained --Electronic comparison of RFP data to ledger --Reports are created showing exceptions/non-matches --Requires ACCESS databases, electronic version of the ledger	--RFP purchase manually entered into Excel file --Manual comparison of RFP data in the Excel file to ledger --“Checkmarks” next to each line item in the ledger indicate that the item has been reconciled to supporting documentation.	--Manual comparison of RFP data to ledger --“Checkmarks” next to each line item in the ledger indicate that the item has been reconciled to supporting documentation.