

FINANCIAL MANAGEMENT AND INTERNAL CONTROLS

Introduction:

A critical component of the University's internal control environment over financial transactions is the departmental Financial Management activities of analyzing, reviewing and reconciling transactions in a timely manner.

There are limited preventive (or "front-end") internal controls for the processing of revenue and expenditure transactions due to established University procedures, as well as the decentralized University environment. Furthermore, within the initiating departments (at the "back-end"), there is no single internal control that would detect incorrect, unauthorized or inappropriate transactions. Rather there is a set of controls working together to mitigate risk to acceptable levels.

The purpose of this document is to:

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

Financial Management:

The expectations and recommendations outlined in this document are proven to be effective measures for Financial Management; however, they cannot be relied upon to prevent all instances of errors, misuse and fraud. Furthermore, these recommended internal control activities are detective in nature and are designed to provide reasonable assurance that errors, misuse or fraud would be detected in a timely manner.

The objective of Financial Management is to have an effective and efficient process in place at the department for each Financial Activity Object (FAO) utilizing the following internal controls:

- 1) Financial Analysis
- 2) FAO Review
- 3) FAO Reconciliation

Implementing these controls can be challenging, especially for both very small departments with few staff resources and for very large departments that have many FAOs and transactions every month. Effective Financial Management must balance the risk associated with each FAO and the resources available to complete the internal control procedures.

This document describes expectations for proper internal controls over all FAOs, including those associated with the Sponsored Awards. However, this document does not replace or override documented guidelines provided by ORPA, ORACS or CLASP.

Implementing FAO Internal Controls:

The first step is completing a FAO Inventory and Self-Analysis Worksheet (Appendix B). The FAO Inventory identifies all FAOs within a department. Performing the Self-Analysis assists in determining which internal control procedures will be used to address the risk associated with each FAO and documents department management expectation of the scrutiny and accountability placed on these FAOs.

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FAO INTERNAL CONTROL DEFINITIONS

Cost-Benefit Analysis:

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

Detective Controls:

Internal controls designed to provide reasonable assurance that errors, abuse and fraud will be detected in a timely manner. Examples of detective controls include: financial analysis, FAO review and FAO reconciliation.

High Risk Areas:

- Transactions that are high dollar amounts, unusual, unrecognized, and/or susceptible to fraud.
- PCards, gift cards, petty cash, payments to study participants, check requests, cell phone usage, and payroll (including Extra Compensation).
- Travel and conference reimbursements and other reimbursements to employees such as mileage, food, and supplies.

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, business and donor intent and (3) producing reliable financial statements based on accurate and verifiable data.

Preventive Controls:

Internal Controls designed to provide reasonable assurance that errors, abuse and fraud will be prevented. Examples of preventive controls include: system ID/password protections, authorization policies, segregation of duties and physical asset safeguarding.

Segregation of Duties:

Segregation of duties is a basic preventive control. 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.

Financial Activity Object (FAO):

FAOs replace the account numbers in FRS. There are currently six FAO tags, GR (Grant), OP (Operating Program), GF (Gift), PR (Project), DS (Debt Service) and LN (Loan Program).

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 a financial transaction. Supporting documentation should always be self-explanatory and not require verbal explanation.

Risk Assessment:

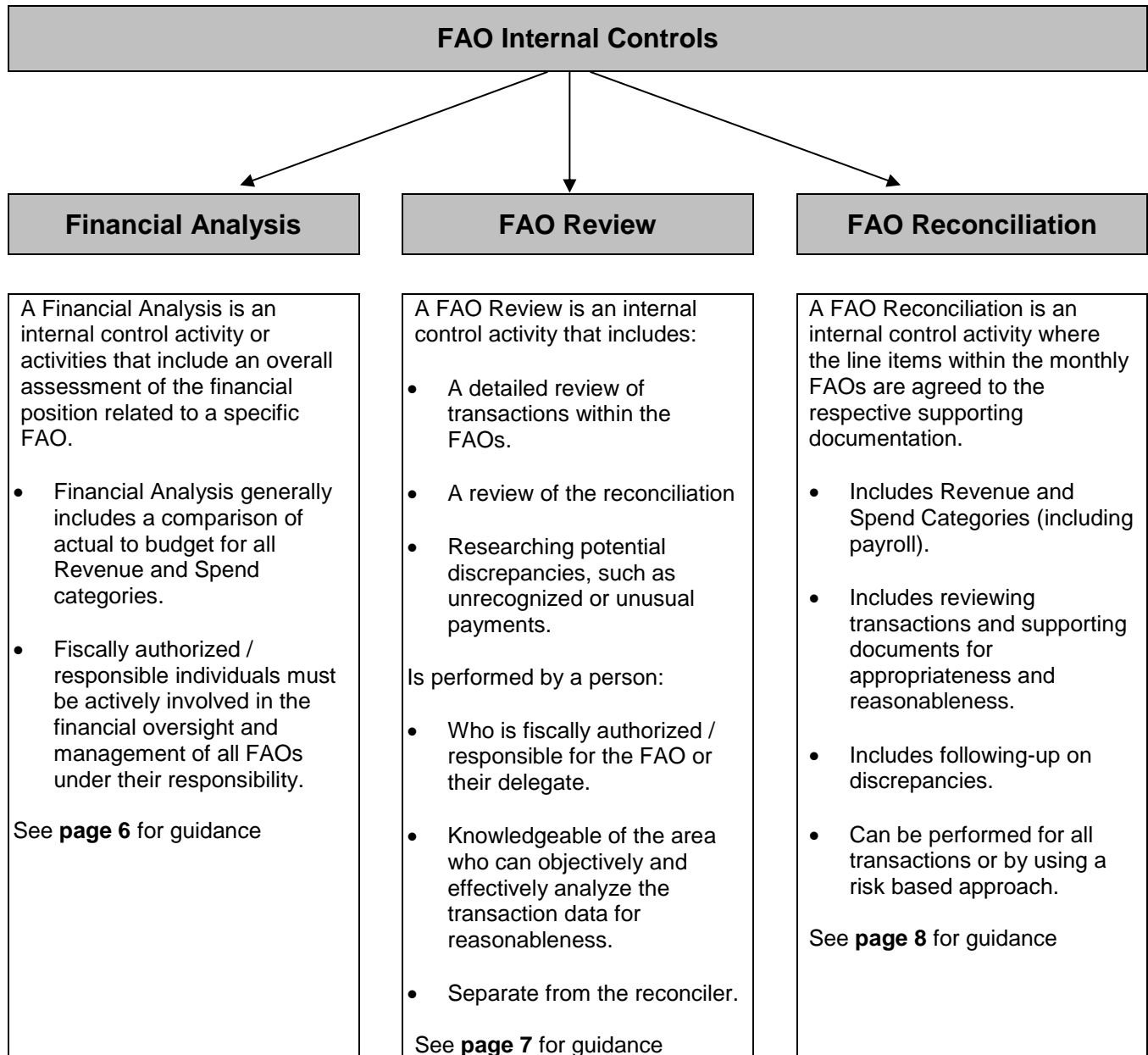
An analysis designed to identify events that could adversely impact the achievement of objectives (i.e., risks). Identified risks are evaluated in terms of likelihood of occurrence and perceived impact. Risks that are ranked high should be mitigated by internal controls.

Fiscally Authorized/Responsible Individual:

Person or persons (i.e., the Chair, Director, Dean, VP or PI) with the direct responsibility to ensure that departmental FAOs are properly managed and are being utilized for appropriate business purposes.

OVERVIEW OF FAO INTERNAL CONTROLS

The following section provides a summary of the three FAO internal controls discussed in this document.



DETAILED GUIDANCE FOR:

1) Financial Analysis:

Definition:

A Financial Analysis is an internal control activity or activities that include an overall assessment of the financial position related to a specific FAO. This analysis generally includes a comparison of actual to budget for all Revenue and Spend Categories (including payroll) as well as developing projections. Large and/or unusual variances are investigated and explained.

Expectation:

All departments should have a formal process that ensures FAOs are analyzed on a routine basis and from a high-level financial viewpoint. This includes the involvement of the individual who is fiscally authorized/responsible for the FAO, i.e., the Chair, Director, Dean, VP or PI. To support this expectation the following can be utilized:

- Budgets are established for all relevant Revenue/Spend Categories and inputs that are used in the budget development process are reviewed to ensure reasonableness.
- Spreadsheets and/or shadow accounting systems are maintained to record and monitor actual monthly amounts (by Revenue/Spend Category) and to compare them to the established budgets.
- Monthly and annual trends are analyzed and discrepancies are investigated.
- Deficit Revenue/Spend Categories, or those Revenue/Spend Categories approaching deficit, should be immediately investigated. Revenue short-falls are also investigated.
- Unexplained surpluses in revenue or FAOs with a surplus balance are investigated.
- Findings, conclusions and actions plans are documented.

Financial reports and analyses related to individual FAOs are generally prepared by the financial support staff working in individual departments (i.e., administrators, accountants, analysts, etc.) using data obtained from UR Financials. An inherent risk is that the staff preparing financial reports could intentionally or unintentionally modify the financial reports and / or the underlying data. As such, fiscally authorized/responsible individuals must ensure that there are internal controls in place to effectively mitigate this risk, which includes active involvement in the financial oversight and management of all FAOs under their responsibility.

To further address this risk, a periodic (and independent) validation of the financial information being provided by the financial support team should be performed. Methods to obtain independent validation can include:

1. Obtaining UR Financials access directly so that, at any time, a fiscally authorized / responsible individual is capable of independently running reports to verify financial activity and to review the detailed transactions that are posted to their FAOs.
2. Arranging for periodic FAO reporting (transaction details and summary reports) to be provided directly by an individual with UR Financials access, but who is independent of the financial support staff.
3. Other review procedures established by, or developed in consultation with, the fiscally authorized/responsible individual to ensure that the inherent data integrity risks are addressed and effectively mitigated.

A risk based approach can be utilized to determine the frequency of the independent validation of each FAO.

2) **FAO Review:**

Definition:

A FAO Review is an internal control activity performed by an individual referred to as the “Reviewer” that includes:

- A detailed review of transactions within a FAO posted during a defined period 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.
- A review of the FAO reconciliation for accuracy and completeness, if the reconciliation was performed.

Minimum Expectation:

At a minimum, all departments should have a formal process that ensures FAOs are reviewed on a timely and routine basis.

- The Reviewer performs a cursory review of all transactions posted to the FAO with particular attention to any high risk, unusual and unrecognized items. The Reviewer should be:
 - An employee who is knowledgeable of the financial and business matters related to the FAO being reviewed.
 - For Sponsored Award FAOs, the PI should be performing the review and signing a PI sign-off form.
- FAO reconciliations are reviewed to verify that they were properly and accurately completed.
 - For proper segregation of duties, the review of the FAO reconciliation should not be performed by the same person that performs the FAO reconciliation.
- The Department Chair/Director/Dean/VP/PI should formally acknowledge the acceptance of risk associated with any process that does not meet the ideal expectation discussed below.

Ideal Expectation:

A “self-audit” would be performed on a sample of transactions on a monthly basis by the “Reviewer” for that FAO. The sample could include unusual payee/vendor, an unrecognized individual, cash distributions or any other factor determined by the individual selecting the transactions. The “self-audit” includes examination and verification of the original documentation without relying on the individuals that requested or approved the transaction for the purpose of addressing the following:

- What is the transaction for?
- Does this transaction represent a valid business expense?
- Who is the person requesting the transaction and what is their title?
- Who approved the transaction and what is their title? (Confirm the validity of the transaction with the approver.)
- What is the reporting relationship between requestor and approver?

In many departments, staff or senior accountants prepare financial reports and perform FAO reconciliations which are often reviewed by a supervisor or individual with a higher level of fiscal responsibility. In addition, all of the individuals involved in the process have the ability (regardless of "level") to process financial transactions that ultimately post to UR Financials. Department administrators, for example, often review completed work products while performing all (or some) of the duties related to transaction processing, FAO reconciliations, FAO reviews, and financial reporting. Although there is often a two-level (or multiple staff) process that provides certain checks and balances, it must be acknowledged that the effectiveness of the controls could be diminished or bypassed. Therefore, fiscally authorized/responsible individuals must understand the control processes that are in place for their FAOs and must provide an adequate level of oversight over those individuals who perform the reviews and reconciliations for their FAOs.

3) **FAO Reconciliation:**

Definition:

A FAO Reconciliation is an internal control activity where the transactions within a FAO report are agreed to the respective supporting documentation.

- This includes reconciling revenue and spend (including payroll) categories. Note: Appendix C provides further assistance for reconciling payroll transactions.
- In addition to agreeing dollar amounts and descriptions to supporting documentation, the FAO reconciliation also involves reviewing the transactions for appropriateness and reasonableness. A follow-up on discrepancies is also performed. Appropriateness and reasonableness can be evaluated by being mindful of the department's business operations, 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?
 - Does the spend/revenue category make sense based on the nature of the transaction?
 - 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?
 - Is the supporting documentation such as an invoice accurately calculated?
- The individual performing the reconciliation is referred to as the "*Preparer*".
- The FAO reconciliation should be more than a mechanical exercise. A true understanding of the nature and business purpose of the transaction is essential, including verification of proper authorization.
- Document Flow - Upon approval of any expenses, the authorized approver should submit a copy of all approved documentation (i.e. travel and conference reports, etc.) directly to the individual reconciling the FAO. Allowing the requestor to submit the approved documents directly to the Reconciler breaks the chain of approval as it enables individuals to submit forged or altered documents. Document flow in conjunction with financial analysis, FAO review and FAO reconciliation create a basis for adequate oversight and monitoring to help ensure the proper approval of documents.
 - The Reconciler should not accept copies of documents directly from the requestor. If the Reconciler has a FAO charge without matching paperwork, they should request that documentation from the approver.

- In the event the Reconciler obtains the documentation from the requestor, they should validate the authenticity of the document with the approver.

Minimum Expectation (Risk Based Approach):

At a minimum, departments should have a formal process that ensures FAOs are reconciled on a regular and timely basis.

- The level to which the FAOs are reconciled should be cost-beneficial and commensurate with the level of assessed risk (i.e., Risk Assessment).
- When reconciling less than the “Ideal”, the method for reconciling should be formally documented (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 FAO reconciliations and for measuring the effectiveness of the FAO reconciliations.
- The Department Chair/Director/Dean/VP/PI should formally acknowledge the acceptance of risk associated with any process that does not meet the ideal expectation discussed below.

Ideal Expectation:

The ideal practice is that a monthly reconciliation is performed for every FAO.

- 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.
- A list or file is maintained for pending FAO 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 feasible, a greater level of management oversight and involvement in the FAO review is required.

4) Evidence:

The completion of the FAO internal control activities (financial analysis, FAO review, FAO reconciliation) should be documented. There are several acceptable practices for documenting the completion of FAO controls; however, all should contain an acknowledgement that the control activity was completed, signatures or initials (electronic is acceptable) by the completing individual, title and date completed. Examples include:

- a. A sign-off form (See Appendix E for an example)
- b. Initialing and dating the hard copy of the printed FAO transaction detail
- c. An electronic log
- d. Emails indicating review and approval

Documentation related to these controls should be maintained per the University’s record retention policy.

APPENDIX A: Shadow Accounting Systems

Purpose / Risk:

The risk of working with electronic FAO reports and shadow accounting systems is that intentional and accidental modifications can be made by the accounting / financial staff within a department. If a department's system of internal controls and financial oversight is not designed properly or operating effectively, the risk of inaccurate financial reporting and the occurrence of fraud are greatly increased. This appendix provides definitions and guidance for effective FAO control procedures involving shadow accounting systems.

Definitions:

- “Shadow Accounting Systems” are financial recording and reporting applications used at the departmental level, such as URGEMS, Miser, QuickBooks or Peachtree. Shadow accounting systems are also used to generate “ledgers” or accounting reports for the purpose of reconciliation, review, and management decision making. Shadow accounting systems are sometimes used for the purpose of establishing real-time or accrual basis accounting records by entering transactions into the shadow accounting systems directly from source documentation (i.e., concurrent with the processing of the paperwork). Transactions can also be recorded after the fact by entering the transactions into the shadow accounting system from reports generated from UR Financials.

Preparer Responsibilities:

- Agrees the FAO data to the shadow system prior to using the shadow system to reconcile transactions or generate financial reports.

Reviewer Responsibilities:

The Reviewer ensures that the shadow system reports used by the Preparer for reconciliation agree to the transactions posted in the UR Financials system. Ideally, departmental financial data should be obtained from the UR Financials system directly by the Reviewer to ensure independence from the Preparer of the reconciliation. This can be accomplished by one of the following methods:

- Running the associated FAO reports directly in UR Financials and validating that FAO balances and transaction details agree to the reconciliation. Direct access to UR Financials requires completion of the eLearning course and the Non Company Level Reporting class prior to receiving system access.
- Receiving FAO reports directly from an individual who has UR Financials access and who is independent and not involved in the processing of departmental financial transactions or FAO reconciliation/review procedures and does not have any other segregation of duties conflicts.

APPENDIX B: FAO Inventory and Self-Analysis Worksheet

FAO	Financial Analysis					FAO Review					FAO Reconciliation			
	Yes / No	How Often	By Whom or Why Not?	Individual or Reason		Yes / No	How Often	By Whom or Why Not?	Individual or Reason		Yes / No	How Often	By Whom or Why Not?	Individual or Reason
OPXXXXXX														
GFXXXXXX														
GRXXXXXX														
PRXXXXXX														
DSXXXXXX														
LNXXXXXX														

Proper segregation of duties must be considered.

Excel version available at <http://www.rochester.edu/adminfinance/audit/index.html>

FAO listings can be obtained by running the following UR Financials Reports:

[View FAO by Company \(Non-Grant\) URF0311](#)

[View FAO by Company \(Grant Only\)](#)

APPENDIX C: Assistance for Reconciling and Reviewing Payroll Transactions

Purpose:

This appendix provides guidance regarding reconciling and reviewing payroll transactions with the objective to have effective and efficient FAO internal control activities over payroll in place at each department. Reconciling and reviewing payroll transactions should be performed with an understanding of the automated controls associated with the HRMS system. Additionally, the manual controls over payroll at the departmental level should be considered.

Risks:

Below is a list of the risks that should be considered when determining a process for reconciling and reviewing payroll transactions.

- Hourly employee records hours not worked
- Ghost / Fictitious employee
- Employee is terminated and still on payroll
- HRMS not updated timely for employee information (rate, termination etc.)
- Employee is paid from the incorrect department
- Fraudulent salary increases

Other Considerations:

There is no “one size fits all” methodology to effective reconciliation and review of payroll transactions. Below is an example of various roles and responsibilities.

Roles	Responsibilities
Payroll FAO Reconciler (Preparer)	<ul style="list-style-type: none"> ◆ Reconciles the Payroll totals from the FAO/Categories to the CUMSAL reports (Alternatively, due to payroll confidentiality concerns, this could be performed by the FAO Reviewer)
Payroll FAO Review (Reviewer)	<ul style="list-style-type: none"> ◆ Reviews the work of the reconciler ◆ Ensures semi-monthly and monthly salary totals are consistent with trends and expectations ◆ Review bi-weekly hourly payroll for reasonableness
Department Administrator and/or CFO (Financial Analysis)	<ul style="list-style-type: none"> ◆ Detail review of CUMSAL to ensure all employees listed are active and belong to the department and that salary and wages are reasonable. Includes: <ul style="list-style-type: none"> ○ Full Time Equivalent (FTE) analysis ○ Verify # of employees for reasonableness ○ Review of employee names ◆ Review and approve all salary changes/adds/deletes ◆ Perform a Financial Analysis (Refer to page 6 of this document)
Timekeeper/ Supervisor	<ul style="list-style-type: none"> ◆ Reviews and approves time entered into HRMS for salary and hourly employees

APPENDIX D: FAO Internal Controls Implementation Checklist:

- Review the document titled “**FINANCIAL MANAGEMENT AND INTERNAL CONTROLS**”
- Inventory all FAOs that are listed in UR Financials as being under your department’s responsibility. (See appendix B for inventory and self-analysis worksheet)
- Work with your department’s senior management to facilitate a risk analysis of each FAO. (See appendix B for inventory and self-analysis worksheet)
 - For each FAO, determine which FAO internal controls will be performed
 - Determine the frequency and extent that each control will be performed
 - Assign control activities to staff and management
 - Ensure consideration is given to controls performed by other personnel and departments.
- Determine the most effective way to evidence the completion of each FAO internal control activity
- Document policy and procedures to ensure effective and efficient implementation
- Develop a monitoring process to ensure controls are being performed

APPENDIX E: Sign-Off Form Example:

DEPARTMENT NAME

Fiscal Year: 201X

Month: February

The following FAOs have been reconciled and reviewed for the time period stated above. Any comments have been noted below.

OPXXXXXX	FAO Name
GRXXXXXX	FAO Name
PRXXXXXX	FAO Name
DSXXXXXX	FAO Name

Reconciler Comments:

Reconciler Signature

Date

Reviewer Comments:

Reviewer Signature

Date