SUBSIDIARY LEDGER MANAGEMENT AND INTERNAL CONTROLS

Introduction:

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

There are limited preventative (or "front-end") internal controls for the processing of revenue and expenditure transactions due to the technological limitations of the University's financial systems, 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 subsidiary ledger management and internal control procedures.

Subsidiary Ledger Management:

The expectations and recommendations outlined in this document are proven to be effective measures for subsidiary ledger 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 ledger management is to have an effective and efficient process in place at the department for each ledger account utilizing the following internal controls:

1) Financial Analysis
2) Ledger Review
3) Ledger 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 ledgers and line items every month. Management of these ledgers has to balance the risk associated with the accounts and the resources available.

This document describes 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.

Implementing Subsidiary Ledger Management Controls:

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

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SUBSIDIARY LEDGER 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, ledger review and ledger reconciliation.

High Risk Area:
- Transactions that are high dollar amounts, unusual, unrecognized, and/or susceptible to fraud.
- PCards, gift cards, petty cash, payments to study participants, cell phone usage, office supplies and payroll.
- 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.

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

Segregation of Duties:
Segregation of duties is a basic preventative 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.

Subsidiary Ledger Accounts:
Accounts that begin with 1 through 9.

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.

OVERVIEW OF LEDGER CONTROLS

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

Ledger Controls

Financial Analysis

A Financial Analysis is an internal control activity or activities that include an overall assessment of the financial position related to a specific subsidiary ledger account.

- Financial Analysis generally includes a comparison of actual to budget for all revenue and expense categories.
- Variance analysis performed for SMH accounts is an example of a financial analysis.

See **page 6** for guidance

Ledger Review

A Subsidiary Ledger Review is an internal control activity that includes:

- A detailed review of transactions within the monthly subsidiary ledger accounts.
- A review of the reconciliation for accuracy and completeness, if the reconciliation was performed.

Is performed by a person:

- Knowledgeable of the area who can objectively and effectively analyze the transaction data for reasonableness.
- Independent from the reconciler.

Includes researching potential discrepancies, such as unrecognized or unusual payments.

See **page 7** for guidance

Ledger Reconciliation

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

- Includes revenue and expense (including payroll) sub codes.
- Includes reviewing transactions and supporting documents for appropriateness and reasonableness.
- Includes following-up on discrepancies.
- Can be performed for all transactions or by using a risk based approach.

See **page 8** for guidance

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 subsidiary ledger account. This analysis generally includes a comparison of actual to budget for all revenue and expense (including payroll) sub codes as well as developing revenue and expense projections. Large and/or unusual variances are investigated and explained. Variance analysis performed for SMH accounts is an example of a financial analysis.

Expectation:
All departments should have a formal process that ensures monthly subsidiary ledgers are analyzed from a high-level financial viewpoint by the individual who is fiscally responsible for the subsidiary ledger account i.e., the Chair, Director, Dean, VP or PI. To support this expectation the following can be utilized:

- Budgets are established for all relevant sub-codes 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 (categorically by sub code) and to compare them to the established budgets.
- Monthly and annual trends are analyzed and discrepancies are investigated.
- Deficit sub codes, or those sub codes approaching deficit, should be immediately investigated. Revenue short-falls are also investigated.
- Unexplained surpluses in revenue or under spent expense accounts are investigated.
- Findings, conclusions and actions plans are documented.

DETAILED GUIDANCE FOR:

3) Subsidiary Ledger Review:

Definition:
A Subsidiary Ledger Review is an internal control activity performed by an individual referred to as the *"Reviewer*" that includes:

- A detailed review of transactions within monthly subsidiary ledger accounts 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 ledger reconciliation for accuracy and completeness, if the reconciliation was performed.

Minimum Expectation:
At a minimum, all departments should have a formal process that ensures monthly subsidiary ledgers are reviewed on a timely basis.

- The Reviewer 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 Reviewer should be:
    - The fiscally authorized / responsible individual for that ledger account (Chair/Director/Dean/VP/PI) or their delegate. Note: the delegate should be an individual who meets the segregation of duties criteria.
    - 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 PI sign off form.
- Ledger reconciliations are reviewed to verify that they were properly and accurately completed.
    - For proper segregation of duties, the ledger review should not be performed by the same person that performs the ledger reconciliation.
- The Department Chair/Director/Dean/VP/PI should 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 fiscally authorized / responsible individual for that ledger account (Chair/Director/Dean/VP/PI). The sample should be risk based. It 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 reimbursement for?
- Does this transaction represent a valid business expense?
- Who is the person requesting the reimbursement 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?

Documentation of this "self audit" and the results should be kept for periodic review.

DETAILED GUIDANCE FOR:

3) 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. Note: Appendix C provides further assistance for reconciling payroll transactions.
- In addition to agreeing dollar amounts and descriptions to supporting documentation, a ledger 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?
    - 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 ledger 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 ledger. 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, ledger review and ledger 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 ledger 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.

DETAILED GUIDANCE FOR:

3) Subsidiary Ledger Reconciliation (continued):

Minimum Expectation (Risk Based Approach):
At a minimum, departments should have a formal process that ensures 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).
- 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 ledger reconciliations and for measuring the effectiveness of the ledger reconciliations.
- The Department Chair/Director/Dean/VP/PI should 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 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.
- 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 feasible, a greater level of management oversight and involvement in the ledger review is required.

3) Evidence:

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

- A sign-off form (See Appendix F for an example)
- Initialing and dating the hard copy of the ledgers
- An electronic log
- Emails indicating review and approval

Documentation of open issues, questions and exceptions should also be maintained.

This evidence should be maintained for periodic review per the University's record retention policy.

APPENDIX A: Electronic Ledgers and Shadow Accounting Systems

Purpose / Risk:
The risk of working with electronic ledgers and shadow accounting systems is that intentional and accidental modifications can be made at any level within the organization. This appendix provides definitions and guidance for ledger control procedures involving electronic ledgers and shadow accounting systems.

Definitions:

- "Electronic Ledgers" are subsidiary ledger reports that are generated from FRS or Impromptu / Cognos and downloaded to an un-editable or editable format, such as PDF or Excel.

- "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 ledger or accounting reports for the purpose of reconciliation and review. Transactions entered into the shadow accounting systems are generally done directly from the source documentation (i.e., concurrent with the processing of the paperwork), but can also be entered after the fact by entering the transactions from the original (FMB091) or electronic ledger.

Preparer / Reconciler Responsibilities:

- Obtain a copy of the original FBM091 and ensure it agrees to the electronic version being used to reconcile. This usually can be verified by a cursory review, and when applicable, a reconciliation of the check totals from the two reports.

Reviewer Responsibilities:
The reviewer must ensure that the electronic version agrees to the official ledger account. Ideally this should be obtained from a source independent of the Preparer of the reconciliation. This could be accomplished by:

- Running the Impromptu/COGNOS reports directly or by having them run by a person that is not involved with ledger reconciliation/ledger review and does not have any other segregation of duties conflicts. If there is an IT person supporting the department, the Reviewer could request them to run the report monthly.
- Requesting that Finance send the original ledger (FBM091) directly to the reviewer.
- Require that the Preparer include a hard copy of the original ledger (FBM091) that has been agreed (and in some cases reconciled) to the electronic version of the ledger.

APPENDIX B: Account Inventory and Self-Analysis Worksheet

	Financial Analysis					Ledger Review					Ledger Reconciliation				
Ledger Account	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	
1-XXXXX															
2-XXXXX															
3-XXXXX															
4-XXXXX															
5-XXXXX															
6-XXXXX															
7-XXXXX															
9-XXXXX															

Proper segregation of duties must be considered.

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

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 ledger 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 Ledger Reconciler (Preparer)	♦ Reconciles the Payroll totals from the ledger account/sub codes to the CUMSAL reports (Alternatively, due to payroll confidentiality concerns, this could be performed by the Ledger Reviewer)
Payroll Ledger Review (Reviewer)	♦ 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)	♦ Detail review of CUMSAL to ensure all employees listed are active and belong to the department and that salary and wages are reasonable. Includes: o Full Time Equivalent (FTE) analysis o Verify # of employees for reasonableness o 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	♦ Reviews and approves time entered into HRMS for salary and hourly employees

APPENDIX D: Ledger Controls Implementation Checklist:

- ☐ Review the document titled "**SUBSIDIARY LEDGER MANAGEMENT & INTERNAL CONTROLS"** http://www.rochester.edu/adminfinance/audit/index.html

- ☐ Inventory all ledger accounts that are listed in FRS 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 ledger account. (See appendix B for inventory and self-analysis worksheet)

  - ☐ For each ledger account, determine which ledger controls will be performed
  - ☐ Determine the level 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 ledger 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: 2009
Month: February

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

2-xxxxx	Account Name
3-xxxxx	Account Name
4-xxxxx	Account Name
5-xxxxx	Account Name

Reconciler Comments:

_____ _____

Reconciler Signature Date

Reviewer Comments:

_____ _____

Reviewer Signature Date