

WASHINGTON UNIVERSITY

Guide to Internal Controls

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INTRODUCTION

The Guide to Internal Controls was developed to help you establish and maintain effective internal controls in your department/division. By developing effective internal control procedures, we can enhance the University's ability to meet its objectives and reduce potential risks. This guide summarizes fundamental internal control practices for various types of transactions and situations. This guide is intended to assist you in decision making, as well as in day-to-day operations.

Compliance with this guide is expected and is subject to review during internal audits of your department or division. This guide should be used in conjunction with the official policies and procedures of the University. The examples in this guide are not all-inclusive of every control appropriate for each process or department but, instead, serves as an illustration of the most routine transactions/processes.

We welcome your suggestions for future revisions of this guide. Please send comments to the Office of the Controller, Campus Box 1002.

DEFINITION OF INTERNAL CONTROL

"Internal control is broadly defined as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations.
- Reliability of financial reporting.
- Compliance with applicable laws and regulations."

-- Committee of Sponsoring Organizations of the Treadway Commission, May 1994

An internal control can be thought of as something that prevents or detects errors or omissions. Preventive and detective controls are both essential for an effective internal control system.

Preventive controls attempt to prevent or deter undesirable acts from occurring. They are proactive controls, designed to prevent a loss, error, or omission. Examples of preventive controls are separation of duties, proper authorizations, adequate documentation, and physical security over cash and other assets.

Detective controls attempt to detect undesirable acts that have occurred. They provide evidence after-the-fact that a loss or error has occurred, but do not prevent them from occurring. Examples of detective controls are variance analyses, supervisory reviews of account activity, reconciliations, and physical inventories.

CONTROL ENVIRONMENT

The control environment reflects the overall attitude, awareness, and actions of the University's management and employees. It is an environment that supports ethical values and business practices. The University expects all employees, regardless of position, to exhibit the highest levels of integrity and ethical behavior. The University also expects Management to demonstrate leadership behavior that promotes internal control and individual accountability.

The following are examples of the leadership behavior expected of Management:

- Communicate to employees that fraud and conflicts of interest will not be tolerated.
- Communicate to employees that University policies and procedures are important and will be followed.
- Make employees fully aware of their responsibilities, including compliance with internal controls.
- Monitor the internal controls system on an on-going basis.

RESPONSIBILITY FOR INTERNAL CONTROLS

Managers are ultimately responsible for the establishment, maintenance, and adherence to internal controls, as well as setting the appropriate “tone” for their areas. They are responsible for the appropriate use (for example, donor and funding agency restrictions) and control of the resources entrusted to them. Management is accountable to the Board of Trustees, which provides governance, guidance and oversight.

Management is also often accountable to the IRS and the funding agencies of federal and private grants and contracts. Individuals, not management, can also be responsible to federal agencies. In certain cases, an individual or management may be directly liable.

ROLE OF THE OFFICE OF INTERNAL AUDIT

The Office of Internal Audit is responsible for planning and performing internal audits at the University, as well as for investigating financial irregularities. Internal audits assist management by providing independent and objective analyses of activities and controls. Audit scopes can range from a single process to all business activities in a division, department, or school. Internal Audit makes recommendations as a result of those analyses.

The Controller and the Executive Director of Internal Audit and University Compliance are responsible for coordinating the on-campus activities of all external auditors including federal, state, and local government agencies, CPA firms, etc., and will serve as liaisons between external auditors and University departments when appropriate. If your office is contacted by any external audit agency, contact the Controller at 935-9853 or the Executive Director of Internal Audit and University Compliance at 362-4915.

SUSPECTED THEFT OR MISUSE OF ASSETS

Internal Audit is responsible for investigating financial-related fraud at Washington University. Where necessary, such investigations are coordinated with Accounting Services, the Office of Executive Vice Chancellor & General Counsel, Human Resources, or the University Police Department.

- If you, as a member of the Washington University community, are aware of or suspect fraud, theft, embezzlement, or misuse of University assets, we ask that you report the problem to your supervisor, if appropriate, and to the Office of Internal Audit at 362-4910. Any information you provide will be handled confidentially.
- Reports of suspected theft, embezzlement, or misuse of University assets may also be reported on the University Compliance Office hotline at 362-4998. All calls to this hotline are anonymous, unless you choose to leave your name and number so that you can be confidentially contacted if more information is needed. These matters will also be investigated by the Office of Internal Audit.

KEY CONTROL AREAS

ACCOUNTS PAYABLE (Invoices, Check Requests & Travel)

- Original vendor invoices related to purchase orders (with the exception of capital project invoices processed by Facilities) should be sent directly to Accounts Payable by vendors.
- All supporting documentation forwarded to the Accounts Payable department must have the unique AISystem document number written on the upper right hand corner of the document.
- If supporting documentation is not required to be sent to Accounts Payable, it should be retained by the department in accordance with the University's record retention policy. The current policy can be found at <http://aishelp.wustl.edu> under the Help Information section.
- Checks should always be mailed directly to the payee by the Accounts Payable department. See Policy Statement for Special Handling of Accounts Payable Checks. The current policy can be found under the Accounts Payable section at <http://aishelp.wustl.edu>
- In order to ensure that all travel expenses are in compliance with the University's policy and reimbursable, the Policy Statement for Travel Advances & Travel Expenses should be reviewed. The current policy can be found under the Accounts Payable section at <http://aishelp.wustl.edu>
- On-line FIS travel list screens should be reviewed periodically and used to track whether outstanding travel advances and prepaid expenses are cleared on travel expense reports on a timely basis. In addition, the list of outstanding travel advances issued regularly by the Accounting Services department should be reviewed and resolved in a timely manner.

ASSETS, MINOR EQUIPMENT, & INVENTORY

- Assets, including cash, major and minor equipment, inventory, parking permits, etc., should be tracked, physically secured, and safeguarded from unauthorized access, use or theft. Emphasis should be placed on equipment and supplies that could be used or easily sold for personal benefit, such as cameras, laptops, printers, etc. Examples of access controls to safeguard assets include locked doors, filing cabinets, drawers, and safes. The number of individuals with access to the keys or lock combinations should be as few as possible. Locks should be changed when employees who had keys to significant amounts of assets terminate.
- Online fixed asset records should be updated regularly, including asset disposals and asset transfers between areas.
- Departments that have significant amounts of minor equipment, supplies, parking permits and similar assets should maintain a perpetual inventory of items on hand. Items received into inventory should not be expensed when received but recorded to a balance sheet account and expensed only when issued for use. The General Accounting department can assist with establishing a balance sheet inventory account.
- Periodically, a person who is independent of the inventory purchasing and inventory custody functions should physically count the inventory items. A comparison of inventory counts to the department's perpetual inventory "book" records should be performed and all differences investigated. Missing items should be investigated, resolved, and analyzed for possible control deficiencies. "Book" records should be adjusted to the physically counted quantities

if missing items cannot be located. Significant shortages should be reported. See Suspected Theft or Misuse of Assets section.

- Inventory items received and issued should be recorded timely and reconciled regularly so that the current “book” balance is always known.

CASH, CHECKS, and CREDIT CARD HANDLING

- A manual or electronic log of all cash, checks, and credit card payments received should be maintained by an employee without initiation/recording or bank deposit responsibilities. This log should list the amount received, its form (cash, check, or credit card), the payor, and the purpose of the payment. The log should be reconciled to the applicable account in FIS by someone other than the person who maintains the log. For clinical areas, the log should be forwarded to Physician Billing Services (PBS) the next day.
- Two-part receipt forms should be used for over-the-counter payments received, regardless of payment type (cash, check, or credit card). One copy should be provided to the payor and one copy should be kept by the department.
- Checks should be restrictively endorsed immediately upon receipt by stamping or writing “For Deposit Only, Washington University” on the back of the check.
- Cash, checks, and credit card information should be kept in a locked, secure, and restricted facility, such as a drawer or safe, until deposited. Limit who has access and keys/combinations to the locked facility. For security purposes, full 16-digit credit card numbers should not be retained; only the last four digits should be retained.
- All monies should be deposited timely. Normally, on-line receipt vouchers should be entered and deposits should be made within 24 hours of the time the monies are received. If minimal dollar amounts are received, deposits should be made when amounts total \$100 or at least weekly.
- An employee with **no cash handling responsibilities** should verify that the amounts actually deposited equal the amounts from the log or receipts, not from the receipt voucher. This will detect any lost or stolen funds.
- A bank lock-box or remote check deposit system for large volumes of cash and checks should be requested from the Treasury Services Department, rather than having the cash and checks come to the department.
- In clinical areas, an employee with no cash handling responsibilities should verify that all original fee tickets are collected, including those for cancellations, “no-shows”, and post-op visits. Persons who receive cash and check payments should not enter patient charges nor be responsible for clearing the Missing Charges Report items. Cancellation and no-show fee tickets should be compared periodically to patient medical records for consistency.
- No individual school, department or division should have their own bank accounts.
- Only Treasury Services is authorized to establish new bank accounts.

DOCUMENT RETENTION

- Records should be maintained in accordance with the University's record retention policy. The current policy can be found at <http://aishelp.wustl.edu> under the Help Information section. Once the retention period has ended, records should be destroyed appropriately.

GIFT RECEIPTS

- Individuals opening the mail should not have access to the donor's records in ADIS.
- Endorsed checks and cash should be forwarded immediately to Development Services (Danforth) or the Gifts Department (Medical School).
- The department's record of incoming gifts and endowment checks and cash should be reconciled to the University's gift system (ADIS) by an employee without initiation/recording or custody responsibilities to ensure all amounts have been received and deposited.
- Development Services should be notified upon receipt of non-cash gifts.
- Appraisals of non-cash gifts must be made by an outside appraiser and must be paid for by the donor.
- See Cash, Checks and Credit Card Handling.

INTERDEPARTMENTAL BILLING

- Billings should be prepared on a timely basis.
- Interdepartmental bills should be approved on a timely basis.
- Bookstore purchases should be supported with receipts that are approved and signed by an appropriate, authorized individual, and should indicate the business purpose.
- Methods should be in place to ensure all billable goods and services provided are billed and collected.
- All policies should be reviewed in connection with interdepartmental billings. Government grants and contracts cannot be charged more than the cost of services or products. This is further explained in the University's Recharge Center Policy which can be found at <http://spa.wustl.edu>.

PASSWORDS

- Passwords should not be shared with another person or posted. Under no circumstances should an approver share his password with another person.
- Passwords should follow University guidelines.
- Password security should be adjusted upon an employee's termination, transfer, or change in responsibilities. When an employee is terminated, system access should be revoked immediately.

- System user access should be reviewed at least annually to ensure appropriate security is assigned. Accounting Services coordinates this review.

PAYROLL/HUMAN RESOURCES

- In order to comply with federal Wage & Hour requirements, employees in positions classified as **non-exempt** are required to maintain time and attendance records. Employees are to report actual hours worked and other paid and unpaid time off (vacation, sick, etc.) in accordance with Department policy as documented below.
 - When departments require submission of actual hours worked and other paid time off through the Time and Labor System – employees are to accurately record time and attendance which is then submitted to their supervisor or appropriate designee, for approval. The Time and Labor system is a legal record of the hours an employee is at work and paychecks are based upon the time record.
 - Departments using other time keeping records to track actual hours worked and other paid time off – employees are to accurately record time and attendance which is then approved by their supervisor or an appropriate designee. This is a legal record of the hours an employee is at work and paychecks are based upon the time record.
- Overtime for employees in positions classified as non-exempt must be paid at time and one-half of the regular hourly rate for any hours worked beyond 40 in a work week; hours worked up to 40 in a work week are to be paid at straight time. Consistent with federal wage and hour requirements, compensatory time off is not permitted in lieu of overtime payment.
- The advance approval of a supervisor must be obtained before overtime occurs.
- Access to payroll information should be limited to only authorized individuals with a legitimate business purpose.
- Employees must be paid at least minimum wage by law. Benefits eligible employees must be paid at least the amount of the University's entry level wage. Human Resources makes the determination regarding eligibility to be paid the University's entry level wage.
- Children under the age of sixteen may not work at Washington University during the regular school term unless and until the Office of Human Resources receives a work permit.
- Direct deposit of paychecks should be strongly encouraged.
- If you have employees who have not elected to have their paychecks direct deposited, actual payroll checks should be distributed by someone other than the individuals who enter or approve payroll.
- All unclaimed payroll checks should be returned to the Payroll Department if they are not claimed within 30 days. Unclaimed checks should never be given to the individuals who enter or approve payroll.
- Requests for wage information should be directed to The Work Number®. Requests can be made electronically at www.theworknumber.com or by phone, 1-800-367-2884. Requests may also be forwarded to the Office of Human Resources.

- In compliance with federal regulations, Form I-9 (employment eligibility verification) data must be collected and verified within three days of hire.
- Payroll for foreign nationals requires special documentation. Contact the Payroll Office when hiring foreign nationals.
- Any court-ordered garnishments, child support orders, and tax levies should be forwarded immediately to the Danforth Office of Human Resources.
- Employees of the University may not be paid as an independent contractor while they are in an active employment status. An exception to this policy may exist if the individual has established him or herself as an independent contractor (as defined by the IRS) and is performing duties that are separate and distinctly different from work done as an employee. In no instance may an employee be paid as an independent contractor while on an approved leave of absence. The U.S. Internal Revenue Service has rules defining independent contractors versus employees. Contact the University's Tax Department with any questions.

PETTY CASH

- Petty cash should be kept in a locked, secure place. Access to the petty cash fund should be restricted to the custodian and a back-up person. Petty cash should be disbursed only by the custodian (or a back-up person in the custodian's absence).
- Original receipts should be required in order to disburse petty cash. The original receipts should be approved and signed by an appropriate, authorized individual, such as the supervisor of the person to be reimbursed. The following information should be noted on the original receipt: what was purchased (if not obvious on the receipt), the business purpose, and account and fund to be charged. Receipts should be maintained in the petty cash fund box for reconciling.
- The petty cash fund should not be used for personal expenses, personal loans, or the cashing of personal checks.
- Petty cash should be reconciled periodically. The sum of cash on hand plus original receipts plus any outstanding reimbursements should equal the original amount of the fund. The reconciliation should be completed by or verified by someone other than the custodian.
- Periodic, surprise counts of the petty cash fund should be performed by someone other than the custodian, such as a supervisor. These periodic counts should be documented and the documentation maintained in conjunction with the record retention policy. In the event of an unexplained petty cash shortage, see the section on "Suspected Theft or Misuse of Assets".
- Managers should periodically review the need for petty cash funds. If funds are no longer needed, the fund should be closed timely. Contact the Accounting Services Department to close funds.

PURCHASING

- The Supplier Selection Justification form along with competitive bids, if applicable, must be forwarded by the department to the Purchasing Department in advance of any purchase of \$25,000 or more.

- Purchase orders should be obtained in advance of purchases, not after the fact.
- Purchasing via personal reimbursements should be discouraged.
- Sales tax should not be incurred (other than in states in which the University does not have an exemption). Copies of the Missouri sales tax exemption letter, and other states in which the University has received exemption, can be obtained from the Tax Department or online under Sales and Use Tax at <http://tax.wustl.edu> .
- The use of University purchase orders, check requests, procurement cards or other University payment methods to acquire goods and/or services for personal use is not permitted, even if the employee plans to reimburse the University.
- The use of the University's preferred suppliers should be encouraged in order to receive special rates based on contracts the University's Purchasing Services Department has negotiated. The current preferred supplier list can be found at <http://purchasing.wustl.edu>.
- Purchase orders should not be issued to employees.
- Purchase orders rather than blanket orders or free balance invoices should be used whenever possible. Purchase orders reduce the risk of duplicate payment and provide approval of specific items.
- Invoices related to vendor contracts and leases should be monitored for compliance with contract terms to avoid overpayments and insurance claims.
- All purchasing transactions must be in compliance with purchasing policies including the conflict of interest policy. Purchasing policies are available on the Purchasing website at <http://purchasing.wustl.edu/>.

RECONCILIATIONS

Broadly defined, a reconciliation is a comparison of different sets of data to one another in order to ensure the accuracy and completeness of transactions. Integral parts of the reconciliation process include identifying and investigating differences, and taking corrective action, when necessary, to resolve differences. Reconciliations are a critical detective control

Examples of cash and payroll reconciliations that should be performed by departments are:

- Reconciling the dollar amount of cash and checks received per the cash receipts log maintained by the department to the dollar amount actually deposited and recorded in FIS.
- Reconciling actual payroll expenses recorded in FIS to expected payroll expenses.
- Reconciliations should be documented, performed timely (by an employee without custody or approval responsibilities), and approved by management. Supervisors should sign/initial and date all reconciliations indicating their review.
- Procedures should be in place to ensure that reconciling items are resolved timely.
- All supporting documentation should be maintained in accordance with the record retention policy.

REVIEWS BY MANAGEMENT

- Budget to actual expense comparisons, where applicable should be performed and significant differences investigated promptly.
- Transactions, records, and reconciliations should be routinely reviewed to ensure expectations are met as to timeliness, completeness, segregation of duties, propriety of the transaction, etc.
- Unexpected results or unusual transactions should be immediately investigated as they might be indications of theft or fraud. Ask for explanations of unexpected results and ask for reasons for unusual transactions. Question the explanations and reasons if they don't seem right, ask to see the items that were purchased, etc. (See Suspected Theft or Misuse of Assets section in this manual.)
- Reviews of reports and reconciliations should be documented by initialing, dating and briefly indicating the resolution of any follow-up performed on unexpected results or unusual transactions.

SEGREGATION OF DUTIES

Segregation of duties is one of the key concepts of internal controls and often the most difficult to achieve. Segregation of duties reduces the risk of errors/omissions, as well as fraudulent activity. The basic idea underlying segregation of duties is that no employee or group of employees should be in a position both to perpetrate and to conceal errors or fraud in the normal course of their duties. In general, the principal incompatible duties to be segregated are:

- Initiation/Recording
 - Custody
 - Control Procedures (reconciliations or monitoring)
 - Approval
- There should always be appropriate segregation of duties. No one person should:
 - Record transactions and reconcile balances
 - Handle cash and verify deposits
 - Initiate/enter and approve the same transaction (disbursement or HRMS)
 - Enter or approve check requests and have the check returned to them
 - Handle assets and reconcile perpetual records to physical counts

SPREADSHEET CONTROLS

All spreadsheets should be well controlled, but special attention should be paid to those that are used to report financial information or those that are highly complex (i.e. spreadsheets that use formulas or macros and/or pull information from other data sources).

- At least annually, formulas should be reviewed to ensure that they are computing correctly and pulling the correct information from other sources.
- Spreadsheets containing sensitive data should be password protected and/or located in controlled directories. Access to these spreadsheets or files should be periodically reviewed.
- Cells with complicated formulas should be locked in order to prevent accidental manipulation of the formula.

TRANSACTION APPROVAL

- Transaction review and approval is an important control activity. Approval of a transaction means that the approver has reviewed the supporting documentation and is satisfied that the transaction is appropriate, accurate, and complies with University policies and procedures.
- Before a transaction is approved, approvers should
 - review supporting documentation, ensuring that necessary information is present to justify the transaction
 - verify the accuracy of the subclass/object (budget/object code)
 - question unusual items (vendors or transactions)
 - ensure "unallowables" are not charged to grants or contracts, if applicable
 - ensure expenses are consistent with donor intentions and restrictions, if applicable
 - ensure that the payee name and address on disbursement related transactions matches the supporting documentation
- Approval authority should only be given to individuals with sufficient authority and knowledge to recognize and challenge unusual transactions. All unusual items should be questioned, no matter how small the dollar amount.
- Approval authority should be linked to specific dollar levels. Transactions that exceed the specified dollar amount should require approval at a higher level. Transactions should not be split to avoid higher approval levels.
- A person should never approve a transaction for which they are the payee.
- If the approver notes any transaction(s) that, after investigation, is not a legitimate department expense, they should contact their supervisor. See “Suspected Theft or Misuse of Assets” section.
- Approval authority should be delegated to officers and employees of the University in accordance with the Omnibus Delegation of Signature Authority policy effective 12/1/2008.