

<b>SUBJECT:</b> Internal Control Policy	<b>Effective Date:</b> 9-23-2015	<b>Policy Number:</b> 2-008	
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	<b>Responsible Authority:</b> Chief Audit Executive		

### **APPLICABILITY/ACCOUNTABILITY**

This policy applies to all members of the university community, including direct support organizations (DSOs).

### **BACKGROUND**

Internal control is a process, affected by the university’s board, administration, and other personnel, designed to provide reasonable assurance regarding the achievement of management’s objectives relating to operations, performance reporting, and compliance.

Within the University of Central Florida (UCF), a number of groups and individuals play key roles in designing, implementing, monitoring, and adjusting internal controls.

As discussed in its 2013 position paper, *The Three Lines of Defense in Effective Risk Management and Control*, the Institute of Internal Auditors notes that:

- a) Management control is the first line of defense in risk management. Management sets the “tone at the top” and makes the final decisions on internal control design and implementation.
- b) The various risk control and compliance oversight functions established by management to assist them by providing subject matter expertise, regulatory interpretation, and oversight, along with policy and procedure development, serve as the second line of defense.
- c) The third line of defense is delivered by internal and external audit functions. Their role is to provide independent assurance on how well internal controls are working and whether there are opportunities to improve internal controls to more effectively and efficiently achieve objectives and manage risk.

## **POLICY STATEMENT**

UCF is committed to maintaining appropriate internal controls to keep the university focused on achieving its mission and objectives, while identifying positive opportunities and avoiding negative consequences.

Based on their areas of responsibility and position within the university, all employees will play a role in designing, implementing, adhering to, monitoring and revising as necessary, UCF's portfolio of internal controls.

## **DEFINITIONS**

**COSO Framework.** The Committee of Sponsoring Organizations (COSO) Framework. The COSO framework was designed to provide guidance on internal control, enterprise risk management, and fraud deterrence. The five COSO components of internal control are the control environment, risk assessment, control activities, information and communication, and monitoring. For an internal control system to be effective, all five components must operate together in an integrated manner.

**Detective control.** A process that helps identify an adverse action after it has occurred.

**Effectiveness.** The degree to which an internal control as designed and implemented is successful in producing a desired result on a consistent basis.

**Efficiency.** The degree to which an internal control is simple and easy to perform, has the minimal number of steps required to complete the internal control, and is easy to monitor and audit.

**Inherent risk.** The probability of loss arising out of circumstances or existing in an environment, in the absence of any action to control or modify the circumstances.

**Internal control.** Internal control is a process, affected by the university's board, administration, and other personnel, designed to provide reasonable assurance regarding the achievement of management's objectives relating to operations, reporting, and compliance.

**Management override.** Action taken by management to circumvent a preventive or detective control. Because leaders are responsible for setting an appropriate tone at the top and for the integrity of the internal control systems within their areas of responsibility, they are explicitly prohibited from overriding established controls or otherwise exerting undue influence intended to cause other faculty or staff to violate policy or laws or to circumvent internal controls.

**Monitoring.** Management's evaluation of (1) whether controls that have been designed to reduce risks to an acceptable level continue to operate effectively and (2) whether the design of controls should be changed as risks change.

**Preventive control.** A process that helps to stop an adverse action from occurring.

**Residual risk.** Exposure to loss remaining after other known risks have been countered, factored in, or eliminated using internal controls or other risk mitigation tools.

## **ROLES AND RESPONSIBILITIES**

Clarification on the roles of key parties and areas of accountability for internal control is provided below. Specifically:

- A. The Board of Trustees has been assigned responsibility by the Board of Governors for setting the institutional expectations for internal control, ensuring management is aware of those expectations, requiring communication channels to be open through all levels of management, and evaluating management's effectiveness at practicing an effective internal control environment and implementing effective internal control policies and procedures.
- B. Management control is the first line of defense in risk management. Individuals with delegated approval authority, e.g., vice presidents, deans, directors, and department chairs, are responsible for establishing, maintaining, and supporting a system of internal controls within their areas of responsibility, for creating the control environment which encourages compliance with university policies and procedures, and for setting a strong "tone at the top" in terms of leading by example.
- C. Adequate management supervision, including proactive oversight, is necessary to ensure that internal controls are operating as intended and to ensure the reliability of accounting and operational controls by pointing out errors, omissions, exceptions, and inconsistencies in procedures. This supervision is required regardless of whether the controls are performed by internal personnel or by an external service/outsourcing provider.
- D. Faculty and staff in leadership roles are responsible for the application of this policy and the design, development, implementation, and maintenance of systems of internal control activities focusing on the effectiveness of operations and the safeguarding of assets within their respective areas of responsibility.
- E. Faculty and staff in leadership positions have the responsibility to ensure that those who report to them have adequate knowledge, skills, and abilities to function within and contribute to an effective internal control environment. This includes providing access to appropriate training on topics relevant to employees' job responsibilities. As requested, University Audit will assist in providing training on internal controls and related frameworks and processes.
- F. All levels of management and supervision are responsible for strengthening internal controls when weaknesses are detected. Department managers should periodically review

and update departmental procedures to ensure that the general principles of internal control are continuing to be followed.

- G. The Finance and Accounting Department (and DSO equivalents) has the primary responsibility for designing and implementing internal controls over financial reporting and compliance with applicable laws, rules, and regulations. Finance and Accounting is the university source for information and assistance to faculty and staff leadership on this topic.
- H. The Human Resources Department (and DSO equivalents) is primarily responsible for designing and implementing internal controls over employee recruitment, hiring, separation, promotion, job classification, employee rights, and salary administration. Human Resources Department is the university source for information and assistance to faculty and staff leadership on this topic.
- I. The Computer Services and Telecommunications (CS&T) Department (and DSO, department, and college equivalents) is primarily responsible for establishing internal controls relating to the design of information technology infrastructure, security management, network intrusion detection, and information technology acquisition, development, and maintenance. CS&T will also assist end users and data owners in developing system, data, file, and program access controls. They can provide expertise to implement best practices such as data classification, role-based access, and “least privileges” concepts.
- J. The Office of Research and Commercialization is responsible for designing and implementing internal controls which help ensure that research conducted at UCF is in compliance with regulatory requirements and meets the highest standards of responsible conduct.
- K. The University Compliance, Ethics, and Risk Office provides oversight of the university’s compliance, ethics, and risk program and efforts and provides guidance on the development of policies and procedures and other internal controls to support compliance, risk mitigation, and prevention and detection of misconduct.
- L. University Audit provides independent assurance by reviewing the adequacy of departmental and university-level internal controls and identifying opportunities for improving internal controls to more effectively achieve objectives and manage risk. For the large majority of its work, University Audit uses the COSO internal control framework to perform control assurance work and reports any weaknesses to the appropriate level of campus management and the UCF Board of Trustees.
- M. External auditors also provide independent assurance and review the adequacy of all levels and types of internal controls over finance and compliance and may provide recommendations or require the university to take corrective actions.
- N. Department managers are responsible for performing prompt corrective action on all

internal control findings and recommendations made by internal and external auditors. The audit process is completed only after managers receive the audit results and take action to correct internal control weaknesses, improve systems, or demonstrate that additional management action is not warranted. University Audit will review all issues identified in its audit reports to determine whether appropriate corrective action has occurred and provide status updates on these follow-up activities to the Board of Trustees. University Audit will also work with department managers and other key parties to provide guidance relating to remediation efforts for recommendations made by external auditors.

## **KEY PROCESSES AND ACTIVITIES**

### **I. Internal Control Development Process**

In its role as the “first line of defense,” management is responsible for the design and implementation of internal controls which expedite decision-making and enhance performance by:

- providing reliable data
- safeguarding assets and essential records
- promoting process consistency, operational efficiency and customer satisfaction
- encouraging adherence to management policies, regulatory compliance, and funding source requirements

Management must assess the costs, benefits, and risks associated with its mission and objectives when designing and implementing controls to develop an internal control environment. The intent should be to reduce inherent risk to a manageable level of residual risk consistent with the university’s risk appetite.

Management is also responsible for selecting efficient and effective internal controls. For example, the frequency with which a control needs to be performed and the appropriate timing of performance should be considered. Also, any potential unintended consequences, such as impact to other departments or external stakeholders, should be evaluated prior to implementation.

Costs associated with internal controls should not exceed their risk mitigation benefit, nor should excessive controls be implemented to stifle mission effectiveness, objective achievement, customer satisfaction, and timely action.

Periodic review should be performed to verify that all of these factors remain in balance.

### **II. Internal Control Communication Process**

Once internal controls are designed and implemented, management should take proactive steps to communicate this information to individuals directly involved in performing the control, along with individuals from other areas that will be impacted by the control.

Failure to inform impacted parties and increase awareness of the existence of and required compliance with internal controls can lead to risk scenarios and negative implications similar to those from not designing and implementing internal controls at all.

### III. Key Control Activities

Listed below are a number of control activities that management must consider when developing and implementing relevant processes.

- A. **Separation of Duties.** Individual duties are separated so that one person's work routinely serves as a complementary check on another person's work. No one person has complete control over more than one key processing function or activity, such as authorizing, approving, certifying, disbursing, receiving, or reconciling. Separation of duties provides necessary checks and balances to detect error and prevent concealment of irregularities. This concept includes both physical controls and system access controls.
- B. **Authorization and Approval.** Proposed transactions are authorized when they are proper and consistent with university policy and the university's plans. Transactions are approved by the person delegated approval authority (see UCF Policy 3-207.1 *Departmental Authorization Lists* and UCF Policy 2-107.3 *Signature Authority* for additional information). Approval authority is usually conferred on the basis of some special knowledge or competency and may be electronic or in writing. The timing of authorization and approval is typically prior to the activity or transaction taking place to make it a preventive control.
- C. **Supporting Documentation.** Relevant documents exist to support and provide complete information about transactions. Documentation may be printed or electronic and should be sufficient to clearly explain the transaction to someone, for example a federal auditor, inquiring about it at a later date. Documentation minimizes the risk of penalties and fines due to unsubstantiated transactions. Refer to the state of Florida's *General Records Schedule GS5 for Public Universities and Colleges* and *General Records Schedule GS1-SL for State and Local Government Agencies* for specific document retention requirements.
- D. **Supervisory Review.** Supervisors are required to review and compare actual revenue and expenditures to budgets on a regular basis to assure fiscal accountability. Supervisors must be satisfied that they have first-hand knowledge or sufficient documentation to confirm that transactions are reasonable, necessary, and appropriate; have been charged to the correct department or project; and were properly authorized and approved by their department. In addition, management should compare actual performance to planned or expected results throughout the department or university and analyze significant differences.
- E. **Reconciliation.** Reconciliation is the process of comparing transactions and activity to supporting documentation; it ensures the accuracy and validity of financial information and that unauthorized changes have not occurred to transactions during processing (e.g.,

an unauthorized credit card refund). Further, reconciliation involves resolving any discrepancies that may have been identified.

- F. **Physical Security.** University assets and records should be kept secure at all times to prevent unauthorized access, theft, loss, or damage. The security of assets and records is essential for ongoing operations, accuracy of information, and privacy of personal information included in some records, and in many cases is a state or federal law.
- G. **System and Application Security.** Access to automated UCF systems, applications, servers, databases, shared drives, and other automated or electronic resources should be based on need to perform required duties as designated by job title, job grade, administrative level access requirements, or internal control procedure documentation. Access should be designed and periodically monitored initially to determine whether it is still required as a person's role changes; access should be removed for individuals who leave the university or transfer to a different department or function.
- H. **Policies and Procedures.** Policies are the guidelines that ensure consistency and compliance with the university's strategic direction. Procedures define the specific instructions necessary to perform a task or part of a process. Together, policies and procedures ensure that a point of view held by the Board of Trustees is translated into steps that result in an outcome compatible with that view. UCF policies and procedures are available at <http://policies.ucf.edu/>.
- I. **Training.** Employees should be properly trained and informed of departmental procedures, including those related to internal controls. Relevant and proper training allows for increased employee performance, improved personnel management, and higher levels of employee retention.
- J. **Performance Evaluation.** Supervisors meet at least annually with their A&P and USPS employees to discuss an overall assessment of each employee's performance over the previous 12 months, to verify that the employee's job description accurately reflects the responsibilities of the position, to identify goals that have been met and those where additional effort may be required, and to identify performance, achievement, and development goals for the upcoming year. Faculty receive performance evaluations in accordance with collective bargaining agreements.

## INTERNAL CONTROL BREAKDOWNS

- A. If anyone involved with performing an internal control or impacted by the performance (or lack of performance) of an internal control has a concern with:
- the efficiency or effectiveness of an internal control (*for example, a process not working as intended per documented procedures*)
  - a potential cost savings or service improvement opportunity
  - a potential regulatory violation due to a missing or ineffective procedure, or inconsistent or incomplete process monitoring, then they should contact their supervisor.

If there is a concern regarding raising the issue with the immediate supervisor or next level of management, the issue should be reported directly to University Audit.

- B. Failure to knowingly perform required internal control activities could lead to disciplinary action up to and including termination. If the deficient performance is the result of a) internal control training not being provided to an employee as part of an orientation and development program or b) failure of a supervisor to adequately monitor internal control activities, this could result in disciplinary action being taken against the supervisor, up to and including termination.
- C. If internal control breakdowns (such as management override) are potentially leading to suspected fraudulent activity, individuals should discuss their concerns with their manager or supervisor. If there is a concern regarding raising the issue with the immediate supervisor or next level of management, the issue should be reported directly to University Audit or via the university's IntegrityLine. See UCF Policy 2-800 *Fraud Prevention and Detection* for additional information on reporting suspected fraud, waste, and abuse.
- D. Interfering with an investigation of potential internal control breakdowns or management override may be cause for disciplinary action, up to and including termination.
- E. Retaliating against another employee based on the results of an investigation of internal control breakdowns or management override may be cause for disciplinary action, up to and including termination.

## **RELATED DOCUMENTS**

UCF Policy 2-107.5 Signature Authority <https://policies.ucf.edu/documents/2-107.pdf>

UCF Policy 2-800.1 Fraud Prevention and Detection  
<http://policies.ucf.edu/documents/2-800.1FraudPreventionAndDetectionLetterhead12-2014.pdf>

UCF Policy 3-200.1 Receipt and Deposit of Funds by Departments; Types of Funds Accepted  
<http://policies.ucf.edu/documents/3-200.1ReceiptandDepositofFundsbyDepartmentsTypesofFundsAcceptedFinalonLetterhead.pdf>

UCF Policy 3-207.1 Departmental Authorization Lists  
<http://policies.ucf.edu/documents/3-207DepartmentalAuthorizationList.pdf>

State of Florida General Records Schedule GS5 for Public Universities and Colleges  
<http://dos.myflorida.com/media/693588/gso5.pdf>

State of Florida General Records Schedule GS1-SL for State and Local Government Agencies  
<http://dos.myflorida.com/library-archives/records-management/general-records-schedules/>



Institute of Internal Auditors Position Paper: *The Three Lines of Defense in Effective Risk Management and Control*

<https://na.theiia.org/standards-guidance/Public%20Documents/PP%20The%20Three%20Lines%20of%20Defense%20in%20Effective%20Risk%20Management%20and%20Control.pdf>

## **RELATED INFORMATION**

Committee of Sponsoring Organizations (COSO)

<http://www.coso.org/>

United States Government Accountability Office Standards for Internal Control in the Federal Government (the “Green Book”)

<http://www.gao.gov/greenbook/overview>

Office of Management and Budget (OMB) Circular A-123 - Management's Responsibility for Internal Control

[http://www.whitehouse.gov/omb/circulars\\_a123\\_rev](http://www.whitehouse.gov/omb/circulars_a123_rev)

The Institute of Internal Auditors (IIA)

<https://na.theiia.org/Pages/IIAHome.aspx>

Information Systems and Control Association (ISACA)

<https://www.isaca.org/Pages/default.aspx>

Association of College & University Auditors (AUCA)

[www.acua.org](http://www.acua.org)

## **CONTACTS**

University Audit, 4365 Andromeda Loop N, MH 341, Orlando, FL 32816-0080.

Phone: (407) 823-2889. <http://www.universityaudit.ucf.edu/>

**INITIATING AUTHORITY**

Vice President and Chief of Staff

<b>POLICY APPROVAL</b> (For use by the Office of the President)	
Policy Number: <u>2-008</u>	
Initiating Authority: <u>[Signature]</u>	Date: <u>9-23-15</u>
University Policies and Procedures Committee Chair: <u>[Signature]</u>	Date: <u>9/17/2015</u>
President or Designee: <u>[Signature]</u>	Date: <u>9/23/15</u>