



RUTGERS POLICY

Section: 40.5.1

Section Title: Internal Audit

Policy Name: University Policy on Internal Control

Formerly Book: N/A

Approval Authority: Board of Governors

Responsible Executive: The President

Responsible Office: Internal Audit Department

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1. **Policy Statement**

It is the policy of Rutgers University to implement, maintain, and monitor a system of internal controls. The system should be comprised of the following five components:

- an environment that promotes control and an ethical climate,
- a process for identifying and assessing risks to the achievement of institutional goals,
- procedures and other activities that guide employees in achieving those goals
- effective methods of communicating pertinent information timely, and
- a process for monitoring control functionality and periodically assessing performance

Through its authorization of this Policy, the Board of Governors, together with the President and senior management, have established the appropriate tone-at-the-top and emphasized the importance of internal controls and expected standards of conduct across Rutgers.

The University's system of internal controls will be implemented at the institutional level and be complemented and supported by each University unit designing and implementing its own sub-set of controls. University units should customize their controls for their unique goals, risks, and activities. Units' controls will assist management contribute to the institution's strategic mission.

2. **Reason for Policy**

This policy raises awareness about how internal control helps an organization run smoother in pursuit of its goals. The policy also assigns authority and responsibilities related to implementing, maintaining, and monitoring internal control. Management implements internal controls to reasonably assure that objectives in the following broad categories are achieved:

- effectiveness and efficiency of operations
- reliability of internal and external reporting
- safeguarding of University assets
- compliance with applicable laws and regulations

3. **Who Should Read This Policy**
All employees, including student employees
4. **Related Documents**
Internal Control – Integrated Framework (COSO)
International Professional Practices Framework
Charge to the Board of Governors' Committee on Audit
Internal Audit Department Charter
5. **Contacts**
Your University Unit's chief administrator
Compliance
Risk Management
University Counsel
The Controller's Office
Human Resources
Internal Audit Department
6. **The Policy**

40.5.1 UNIVERSITY POLICY ON INTERNAL CONTROL

I. Internal Control At Rutgers

Rutgers establishes its mission, and sets supporting strategies and objectives it seeks to achieve. Administering the objectives set for Rutgers may be assigned and delegated to specific units and activities within the institution. Unit management is held accountable by formulating action plans that identify the steps for achieving these objectives. Internal control is required for management and the institution to be successful.

An effective system of internal control provides management and the Board of Governors reasonable assurance regarding the achievement of Rutgers objectives. The system of control sets forth four categories of objectives for management to focus on:

Operations – pertains to the effectiveness and efficiency of the University's varied lines of business, teaching, research, and services,

Safeguarding of Assets – applies to those assets (including non-public, private and personal information) under the care, custody, and control of University units,

Reporting – includes all information that the University or its units report, share, and distribute, both internally and externally,

Compliance – applies to the myriad laws and regulations that Rutgers activities are subject to

Every Rutgers employee plays a role in the University's internal control system. It is important for management to communicate to his/her employees their respective roles and responsibilities, and respective boundaries (or extent of authority) in the control process. Management captures employees' roles, responsibilities, authority, and duties in each position's formal job description.

II. Assigned Roles and Responsibilities for the University Internal Control Process

a. President and Senior Executives

The President sets the tone at the top that affects control environment factors, standards of conduct, and all other components of internal control. The President shapes the values, principles, and major operating policies that form the foundation of the entity's internal control system.

The President provides leadership and direction to senior management. Guided by strategic plans, the President defines related metrics, targets, or other measurable expectations with which to gauge the ongoing and long-term effectiveness of the system of internal control. The methods for designing, implementing, and assessing internal control are delegated to senior executive management.

b. Unit Management

Unit operating management provides the first line of defense on a day-to-day basis against potential risks. Unit management first identifies and assesses risks, and then establishes controls and writes procedures to mitigate these risks. Unit management supervises the timely execution of those procedures by their employees. In doing so, unit management ensures that activities contribute to the achievement of goals and objectives.

c. Central Administration

The University central administration supports those needs that are common to most university units, such as legal, human resources, research, accounting, purchasing, treasury, technology, compliance, environmental/health, and others. Such business-enabling functions act as the second line of defense.

Senior management establishes these functions to ensure the first line of defense is properly designed, in place, and operating as intended. Even though these functions do not have direct authority over the units comprising the first line of defense, they may use their specialized skills to intervene directly in advising on risks and enhancing internal controls.

These central administrators provide guidance and assessment of internal control related to their areas of expertise. They also keep the organization informed about relevant requirements as they evolve over time (e.g., new or changing laws and regulations).

d. Internal Audit Department

As the third line of defense, the Internal Audit Department is charged with the responsibility for reviewing, evaluating, and testing management's design and implementation of its internal control processes. The authority of the Internal Audit Department is granted through its charter authorized by the Committee on Audit of the Board of Governors. Internal Audit collaborates with management in providing assurance and advisory services on the effectiveness of governance, risk management, and internal control.

All activities within an organization are potentially within the scope of the Internal Audit Departments responsibility. Through the charter, the Committee on Audit authorizes the Internal Audit Department full and free access to University resources to conduct its work and to fulfill its responsibilities. The Internal Audit Department is independent of the first and second lines of defense. It has a functional reporting relationship to the Committee on Audit while reporting administratively to senior management.

Internal Audit is also responsible for communicating reports of audit results to management and the Committee on Audit on the adequacy and effectiveness of the University's internal control, together with ideas, counsel, and objective recommendations for improvement.

III. The Committee on Audit Oversight Role for Rutgers Internal Control System

The overall purpose of the Committee on Audit is to assist the Board of Governors in fulfilling its responsibility for the oversight of the quality, reliability, and integrity of the University's accounting, auditing, compliance, internal control, and financial reporting processes, as well as the independence of the internal and external auditors.

Regarding internal control, the Committee is best positioned to ensure the effectiveness of the three lines of defense.

IV. Other Internal Control Considerations

a. Deficiencies in Internal Control

Deficiencies in internal control may adversely affect the institution or unit's ability to achieve its objectives. The responsibility for identifying and assessing deficiencies rests with management in the course of performing its functions. Management may contact the University's central administrative departments and the Internal Audit Department for assistance when evaluating and correcting control weaknesses.

b. Costs versus Benefits of Internal Control

Internal control provides many benefits to the institution and its units. Controls provide management assurances that progress towards objectives is being achieved, provide feedback on how the unit is functioning, and they help in reducing unwelcome surprises. Having sound controls also may contribute to improved fundraising and facilitate obtaining public sponsors.

Units will always have budgetary constraints and limits on the human and capital resources available to them and, therefore will need to consider the costs of internal control alternatives relative to the benefits. It is up to unit management, with advice from the central administration and Internal Audit, to determine how a unit evaluates the costs versus benefits of alternative approaches to implementing internal controls and the ultimate action it takes.

c. Extent of Internal Control Documentation

Documentation provides visible clarity in communicating the who, what, when, where, and why of how internal control is carried out. Another purpose of documentation is for training new employees and a reference tool to others. Documentation provides management and auditors evidence of the performance of control activities (called the "audit trail"), and enables monitoring that are integral components of internal control.

Management is responsible for developing the appropriate level of documentation for its control process that is commensurate with the complexity of its circumstances and risks. Where the unit is custodian to extensive and valuable assets the level of documentation required will be high. Where the unit has fiduciary responsibilities for federal and state funds, the level of documentation will also be high. In units that are highly regulated or accountable to external third parties, the nature and levels of documentation will be extensive to assert with reasonable assurance that all components of internal control are

present and functioning. In cases where an auditor attests to the effectiveness of the internal controls, the auditor will expect management to provide documented support for its assertion on the effectiveness of control.

Examples of documentation include policies and procedures manuals, organization charts, job descriptions, and flowcharts of business and other important processes. Documentation is also critical in supporting significant judgments and important decisions, and evidencing all business transactions affecting the unit and the University.

d. Limitations of Internal Control

No matter how well designed and implemented, internal control can provide only reasonable assurance to management and the Board of Governors regarding achievement of the University's objectives. A system of internal control cannot provide absolute assurance because of several limitations. Human error, uncertainty inherent in judgment, collusion to circumvent controls, and management override can all cause controls to fail.

V. Definitions

- a. Internal Control - is an ongoing process, designed and implemented by an institution's board, management, and other personnel that provides reasonable assurance that the following objectives will be achieved:
- Effectiveness and efficiency of the institution's operations
 - Reliability of internal and external reports
 - Compliance with all applicable laws and regulations
- b. COSO - is the acronym for the Committee of Sponsoring Organizations of the Treadway Commission. This Committee is comprised of accountants, financial experts, and auditors and authored *Internal Control – Integrated Framework*, the "bible" on the concept of "internal control" and its applications
- c. Internal Audit - is an independent appraisal function within an organization that reviews and evaluates management's design and implementation of the internal control process.
- d. External Audit - is an external third party, usually an accounting firm, engaged annually by the Board to perform the examination of the institution's yearend financial statements. This term, external auditor, may also be applied to federal and state auditors.
- e. Three Lines of Defense – is a model recommended by professional audit literature as an effective way to separate, clarify, and assign roles and responsibilities regarding internal control processes.