



THE UNIVERSITY OF MICHIGAN

STANDARD PRACTICE GUIDE

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Purpose

This policy delineates, in one place, many of the fiscal responsibilities required by the University. It is the responsibility of every faculty and staff member who are involved in any financial activity on behalf of the University to be fiscally responsible and to exercise appropriate financial controls, as outlined in this document and as is relevant to their role. This document defines the five guiding principles for financial control, four essential department level requirements for financial control and provides an outline of the roles and responsibilities that are required by the University (at a minimum) at each level of the organization.

Guiding Principles for Financial Controls

- 1) An optimal control environment calls for clearly defined roles and responsibilities, policies based on principles rather than procedures, and a minimal number of exceptions to those policies.
- 2) The use of management reporting as a control method reduces emphasis on individual transactions and allows management to monitor trends. Standard, unit-specific and Internal Audit reports will be available as management tools.
- 3) Review and approvals provide controls by utilizing clear definitions of what the approvals mean, and also by establishing materiality levels for consistent and meaningful approvals.
- 4) Appropriate documentation standards will assure compliance with various internal and outside oversight agencies' requirements, and also eliminate non-essential documentation.
- 5) The role of Internal Audit will be to focus on high risk or high exposure areas, and through the use of internal control self-assessment programs and horizontal audits, help units to implement best practices in establishing unit control policies and procedures.

Essential Department Level Requirements for Financial Controls

There are four main elements that should exist in all University units that manage their own finances. The University requires these elements for all units (and at all levels) that control their own finances. If your unit has a unique DeptID, this applies to you. Major operating units, sponsoring agencies, donors, etc.



THE UNIVERSITY OF MICHIGAN

STANDARD PRACTICE GUIDE

may impose additional requirements. The minimum requirements are:

1. *Preparation of a Budget Plan (including anticipated revenues and expenses)*
2. *Processing of Financial Transactions*
3. *Financial Review*
4. *Internal Controls and Management Responsibilities*

These elements are similar to the guiding principles described earlier. The difference is the essential Department-level requirements are intended to provide additional guidance in order to help units make the guiding principles operational within their unit. The complexity of organizational structures and the various funding sources within the University may impose additional layers or levels of review above and beyond what is described here but the four main elements (detailed below) represent the minimum requirements.

Preparation of a Budget Plan (including anticipated revenues and expenses)

Budgets should reflect the unit's operational plans for a period of at least one year and ideally represent those plans over several years. Budgets are typically formally adopted and approved on an annual basis and budgets are administered from an annual budget perspective. Once a budget is approved, it should not change unless it goes through a rebudgeting process. Units should clearly define what level of budget change requires a rebudgeting process since this aspect can differ by unit and by type of fund. The budget plan should include all funds available to the unit, including operating and non-operating funds.

The review, approval and endorsement of the budget require an understanding of the major budget components by the unit head. Since budgets live in details, responsibility for budget details are typically delegated to faculty and staff, who have operational decision-making authority. Preparation of a budget requires involvement of the head of the unit and their financial management staff (e.g. department administrator who typically report directly to the unit head).

Processing of Financial Transactions

Individuals with responsibility for processing financial transactions may have the full range of responsibility or have duties associated with a specific activity (e.g. faculty and staff appointments; timecards and gross pay registers; purchasing). Individuals with responsibility for processing any financial transaction must ensure proper approvals have been obtained from individuals with delegated budgetary authority to support the expenditure of University funds. Appropriate written documentation of these approvals should be kept on file. The approval process can vary dramatically by unit so individuals should check with their department for unit policies and procedures.

The most important part of the approval process is the determination of whether the expenditure is appropriate. As such, individuals designated with approval responsibility should be in a position to determine that the financial activity is appropriate. Appropriateness refers to two things: 1) *management review* – whether the expenditure would be considered within the intended use of the budget (or if the



THE UNIVERSITY OF MICHIGAN

STANDARD PRACTICE GUIDE

expenditure is not planned for, is it considered a good use of unit resources) and 2) *compliance review* – whether it is consistent with the relevant policies of the University, donor intent or sponsor guidelines. It is important to note that University policy must be met at a minimum even if the donor intent or sponsor guidelines (e.g., OMB Circular A-21) allow a more lenient approach. In other words, policies are the presiding determinant over all other guidance unless donor or sponsor policies are stricter.

Individuals who authorize commitments must be aware of the relevant policies (including donor intent and sponsor guidelines) that guide expenditure decisions. In organizational structures where one individual may not be in a position to review both aspects of appropriateness as defined above, a two-step approval process may be necessary. In that case, a clear definition of the roles of each approver should be developed. In no case should financial activity exist which cannot successfully pass both management and compliance review.

No one individual should control a financial transaction from start to finish. This point is covered in more detail later in this document under the separation of duties requirement.

Financial Review

Individuals with delegated budgetary responsibility should regularly review budget versus actual activity and budget variances need to be adequately explained. In other words, financial reviews should include the identification of budget variances and the review of financial activity to ensure all financial activity is appropriate and correct. This activity is sometimes described as reconciling the financial statements of activity but reconciliation is only part of the financial review process.

Verifying that required approvals were obtained and adequate documentation exists to support each financial transaction should be part of the review. Management reporting should also include exception and trend reports about the overall operation of the unit and reviews should focus on activity levels and unusual trends. Management reports should be reviewed with unit leadership on a regular basis. Although individual units may use supplemental systems to monitor selected unit trends and activity, the financial review is also necessary to validate that the University's centrally maintained financial data (e.g. statements of activity, gross pay registers, project grant balances) is complete and accurate. The integrity of the financial data maintained in the University's central enterprise-wide M-Pathways system, including the accuracy of revenue and expenditure functional classification, is critical for university-wide reporting, including consolidated financial reporting and state and federal regulatory filings. It is also critical to fully reconcile any supplemental system financial data maintained by departments to the financial data in the central M-Pathways system.

Internal Controls and Management Responsibilities

All managers, from the unit level to the President of the University, should use internal controls to help assure that units operate according to a plan. The methods used are: policies, procedures, organizational structures and physical barriers. Most internal controls can be classified as *preventive* or *detective*. Preventive controls are designed to discourage errors or irregularities (e.g., requiring supervisory sign-off before an item is purchased). Detective controls are designed to identify an error or irregularity after it



THE UNIVERSITY OF MICHIGAN

STANDARD PRACTICE GUIDE

has occurred (e.g., reconciling financial statements of activity to ensure all charges are appropriate and correct). The existence of detective controls can also serve to prevent irregularities. For example, an individual tempted to use departmental funds inappropriately may be deterred by the knowledge that financial statements are regularly reviewed. Through careful design, the system of internal controls can help units operate more efficiently and effectively and provide a reasonable level of assurance that the processes and products for which you are responsible are adequately protected.

All managers are responsible for ensuring that internal controls are established and functioning to achieve the mission and objectives of their units. Adequate internal controls allow managers to delegate responsibilities with reasonable assurance that what they expect to happen, actually does. Any discussion of fundamental management responsibilities would include effectiveness, efficiency, compliance with laws and regulations and accuracy in reporting. *Effectiveness* measures whether an organizational unit achieves its objectives. *Efficiency* measures how well managers make use of available resources in achieving these objectives. While achieving the unit's objectives, managers must also *comply* with applicable policies, regulations and laws. Finally, in order to make sound decisions and comply with oversight requirements, managers must receive *accurate information and reports*. Internal controls can be thought of as a coordinated set of policies and procedures used by managers to ensure that their units operate efficiently and effectively in conformance with applicable policies, regulations and laws.

Financial Oversight Responsibilities by Level

In a large and highly decentralized environment, fiscal responsibilities are distributed throughout the University. The organization structure, in particular the administrative structure, establishes many of the roles and responsibilities for financial management. For example, financial controls are strengthened when separation of duties exists. Financial controls are weakened when one person handles a financial transaction from start to finish. The *adequate separation of duties* requirement is essential in order to maintain an appropriate system of checks and balances.

The administrative capacity of a department to manage their financial activities (e.g., budgeting, transaction processing, financial review and internal controls) needs to be assessed primarily by the major operating unit of which they are a part. For example, as fiscal responsibilities emerge in the role of a Principal Investigator (PI), a PI's department should determine how the financial aspects of the work associated with his/her projects will be done (e.g., which duties are the responsibility of project staff vs. departmental staff). Departments must ensure that *adequate separation of duties* exists. The PI is responsible to review sufficiently the work of others, including oversight of financial matters, in order to provide a reasonable level of assurance that the work is being performed properly and on a timely basis.

Levels for financial management responsibilities are codified within the University's administrative (M-Pathways) systems. A coding scheme is utilized which defines the administrative structure for purposes of management oversight and control. Existing code names, with some examples of organizations within



THE UNIVERSITY OF MICHIGAN

STANDARD PRACTICE GUIDE

each level, are bracketed and shown below:

1. University Level [Appointing Department Group VP Area]
 - a. Executive Officers
2. Major Operating Unit Level [Appointing Department Group]
 - a. Schools/Colleges
 - b. Auxiliary Units
 - c. Administrative Units
3. Department Level [Appointing Department ID]
 - a. Academic Departments
 - b. Functional Departments
4. Project Director/Principal Investigator Level (does not apply to co-PIs)
5. Individual Level (Faculty and Staff)

Review of management reports to identify outliers and trends is an important part of the internal control process. Many management reports are available through the data warehouse for department management's use in monitoring financial trends. A list of reports that should be reviewed, at a minimum, for each business process for each level is available at the following website:

http://www.mais.umich.edu/reporting/download/fin_top_reports.xls

Role of Individual Faculty and Staff with Financial Responsibilities

As indicated in the previous section, in a large and highly decentralized environment, fiscal responsibilities are distributed throughout the University. The organization structure, in particular the administrative structure, establishes many of the roles and responsibilities for financial management. While individual responsibilities are determined in part based on the level in the organization in which they work, certain roles exist at all levels. These roles include:

1. *Executive Management*
2. *Financial Management*
3. *Faculty and Staff with Delegated Financial Authority (including Project Directors and Principal Investigators)*

Executive Management

Individuals who hold executive management positions (including deans, directors, vice presidents, the provost and the president) inherently come with the responsibility for the financial activity occurring in each of their units. These individuals are typically charged with much broader responsibilities and utilize



THE UNIVERSITY OF MICHIGAN

STANDARD PRACTICE GUIDE

budgeting and financial management for purposes of planning and monitoring the activities for their area of responsibility. Since executive management is ultimately responsible for the fiscal integrity of their organization, this role must provide leadership, oversight and management philosophy to ensure that all funds are spent and managed according to the goals, objectives and mission of their organization.

Financial Management

Individuals who hold positions with an oversight role for financial activity typically report to the head of the unit. These individuals (including Department Administrative Managers, Business Managers, and Budget Administrative Group Managers) provide oversight on how funds are spent and managed, including ensuring that funds are budgeted. Duties include: ensuring funds are handled in accordance with relevant fiscal policies (e.g. that funds are spent appropriately in compliance with University policy, as well as the sponsor, donor or federal guidelines); that chartfields are consistently and accurately utilized to record financial transactions; that processes and internal controls are in place; that financial activity is reconciled to the central M-Pathways system on a regular basis, etc.

Expenditures should be managed in conformity with the original budget or where changed circumstances require a use of resources that differ from the original plan, the deviation should be clearly explained and a plan articulated to financially support these changes. Since rebudgeting processes and budget variance explanation requirements can differ by unit and by type of fund, units should clearly define this aspect of their financial operations.

The consistent and accurate use of chartfield values is critical to the University's financial reporting at all levels, from the overall university, to the department, to the project grant. Chartfields represent a series of individual values, which, in a sequence, describe a specific activity. Chartfields include values for budget period, fund, department id, program, project/grant, class (function – e.g. instruction, research, academic support) and account (object – e.g. salaries, benefits, equipment). Reference the related links section in the Appendix to this SPG for additional information on class definitions.

Faculty and Staff with Delegated Financial Authority (including Project Directors and Principal Investigators)

Individuals who are assigned responsibility for any financial activity (including Project Directors, Principal Investigators, Unit Liaisons and Administrative Associates) should clearly understand the financial authority that accompanies this responsibility (e.g. budget, level of authority to make expenditure decisions, etc.). In most cases, this financial authority is granted to an individual who is assigned one of the following two roles: 1) the role of a Project Director (which is assigned to every project/grant within the University) or 2) the role of Department Manager (which is typically assigned to all chartfield combinations without a project/grant or a project director).

The sponsored project environment deserves special mention since this environment places the responsibility for financial management in the hands of many faculty who are not heads of units or in executive management positions. A Principal Investigator (PI) role is typically associated with grants and contracts awarded to the University by external sponsors (e.g. the federal government). While a



THE UNIVERSITY OF MICHIGAN

STANDARD PRACTICE GUIDE

sponsored project may have several co-investigators, there is only one investigator assigned the PI role and the University designates that individual as the Project Director. The PI is the individual with ultimate responsibility for the administrative and programmatic aspects of the project including ensuring funds are spent in accordance with University and sponsor guidelines.

As all sponsored projects are formally awarded to the Regents of the University, the PI is always acting as an agent of the University. Consequently, a PI may not enter into any agreement without approval of the dean, department chair and the Division of Research Development and Administration (DRDA), who collectively represent the University's interests. In addition, the Office of Contract Administration has the delegated authority to sign sponsored contracts on behalf of the University.



THE UNIVERSITY OF MICHIGAN

STANDARD PRACTICE GUIDE

APPENDIX – RELATED TOOLS AND LINKS

Internal Controls – Guide and Questionnaires

All departments/units are responsible for ensuring that internal controls are established and functioning effectively. Most internal controls can be classified as preventive or detective. Preventive controls are designed to discourage errors or irregularities. Detective controls are designed to identify an error or irregularity after it has occurred. The website below provides further guidance with respect to designing internal controls appropriate for your operation.

<http://www.umich.edu/~uaudits/internalcontrol/>

University of Michigan – Statement on Stewardship

All staff with administrative or supervisory responsibilities have a stewardship responsibility to support and enhance the mission of the University, to ensure that the University fulfills its legal and financial obligations to internal and external stakeholders, to safeguard the University's financial, human, information and physical assets, and to create an atmosphere that encourages all members of the University community to contribute to the overall excellence of the University.

This statement outlines fundamental responsibilities inherent in functioning as a steward of University resources and references University documents and offices that provide assistance regarding specific policies and procedures or forms.

<http://www.umich.edu/~hrra/transformation/stewardship.htm>

Administrative Data Policies for Responsible Use of Data

Users of the University's Administrative Data are required to comply with federal laws and University policies that apply to the proper use of data. These policies detail the responsibilities associated with data access and the sanctions that result from misuse.

This web site link also features the University of Michigan's most relevant information technology policies, and guidelines, including responsible use of technology and resources, and handling of data designated as public, private/confidential or sensitive.

<http://www.mais.umich.edu/access/policies.html>

Management Reports – Available from Michigan Administrative Information Service (MAIS) Roadmap

Review of management reports to identify outliers and trends is an important part of the internal control process. Many management reports are available through the data warehouse for department management's use in monitoring financial trends. Predefined reports available on this website can be viewed by business process (e.g. financial controls, project grant financial management, department financial management, p-card activity, endowments management and worklist monitoring)



THE UNIVERSITY OF MICHIGAN

STANDARD PRACTICE GUIDE

<http://www.mais.umich.edu/reporting/roadmapdb.html>.

A list of reports that should be reviewed, at a minimum, for each business process for various levels of financial oversight is available at the following website:

http://www.mais.umich.edu/reporting/download/fin_top_reports.xls

For more information on data reporting see the following website:

<http://www.mais.umich.edu/reporting/index.html>

Expense Class Definitions

All expenses require a class portion of the chartfield to signify the functional classification of each expense. To maintain the integrity of the University's financial records, it is imperative that departments to assign class values appropriately and consistently. This definitions document provides descriptions of each class value (e.g. instruction, research, academic support, and institutional support).

<http://www.umich.edu/~finops/CRO/class.pdf>

Indirect Cost Recovery Excluded (ICRX) Expenditures Policy and Guidance

Certain types of expenditures (e.g. advertising, alcoholic beverages, entertainment, hosting, lobbying, memberships, recruiting) are considered indirect cost recovery excluded (ICRX) expenditures. All ICRX expenditures must be separately flagged or segregated with unique chartfield values to ensure compliance with federal regulations governing the use of these expenditures. It is important that all faculty members and unit administrators are familiar with these requirements. The documents below provide background and guidance for faculty members and unit administrators.

<http://www.research.umich.edu/policies/um/jaftic/jaftic.pdf>

<http://www.umich.edu/~finops/CRO/icrx.pdf>

http://www.umich.edu/~finops/CRO/uofm_docs.htm