



CLARK SCHAEFER HACKETT
BUSINESS ADVISORS

Segregation of Duties *in Small Governments*

Presented by:
Larry Weeks, CPA

Overview

- Summary of Objectives
 - Understand how segregation of duties fits into internal control structure.
 - Understand nature of internal controls.
 - Identify proper manner to segregate different accounting functions.
 - Be able to identify deficiencies in segregation of duties
 - Understand alternative procedures to implement when proper segregation of duties is not possible.

Internal Control Structure

- Process implemented by entity to provide reasonable assurance:
 - Information process is accurate, complete, and timely.
 - Compliance with applicable laws, regulations, and contracts.
 - Safeguarding of entity's assets.
- Cost-Benefit of internal control structure:
 - Primary concept is the cost of implementing and operating a control procedure should not outweigh the benefit anticipated to be derived.
 - Usually comes down to operation delays or impairments due to performing control procedure.

Internal Control Structure

- Structure consists of five (5) interrelated processes:
 - Control environment
 - Risk Assessment
 - Control Activities
 - Information and Communication
 - Monitoring

Internal Control Structure

- Types of controls to be implemented to mitigate existing risks:
 - Preventative controls – typically occurs while the transaction is occurring or as the transaction is being recorded in the accounting system. Preventative controls are intended to prevent errors or issues from occurring in the first place.
 - Detection controls – typically occurs after the transaction has occurred and has been recorded in the accounting records. Detection controls are intended to detect errors or issues that have already occurred so they can be corrected on a timely basis.

Internal Control Structure

- Preventative Controls:
 - Purchasing limits/credit restrictions
 - Required approvals and signatures
 - Automated IT controls applied to each transaction
 - Entity-wide policies
 - Restricting access to assets and utilizing IT security features
 - Pre-numbered documents
 - Pre-employment screening of employees and proper job training

Internal Control Structure

- Detective Controls:
 - Monthly reconciliations of transactions
 - Physical inventory of tangible assets
 - Required rotation of job duties/mandatory vacations
 - Monitoring of actual activity against budgeted, prior year, and/or forecasted amounts
 - Making sufficient inquiries of appropriate individual regarding unanticipated results or trends

Segregation of Duties

- What is segregation of duties?
 - ✓ Segregation of duties is largely the practice of having different individuals responsible for the authorization, recording, and reconciling transactions recorded within the entity's general ledger.
 - ✓ Typically viewed as a preventative control as separating the individual tasks within a transaction cycle is done to reduce the risk that errors or omissions will occur in the first place.

Transaction Cycle

- Authorization of transaction
 - Approves billing invoices or voucher/invoice for payment
- Receives or disburses cash
 - Receives cash or distributes vendor/payroll checks
- Records transaction
 - Enters cash receipts or disbursements into general ledger
- Reconciliation of transaction accounts
 - Periodically reconciles cash receipt and disbursement accounts to the cash deposits maintained

Separation of Duties

- ABC's of separation of duties is where no one individual has a job function in more than one of the following three areas:
 1. Asset handling or disposition, which is having physical access to asset (cash, equipment, or checks) or ability to direct use of asset (wire transfer, account adjustment, ordering services, or supplies).
 2. Bookkeeping or recording of transaction function which is recording cash receipts, disbursements, and/or journal entries into the accounting system.
 3. Comparison or reconciliation transactions within general ledger for validity and reasonableness.

Separation of Duties

- Another way to view appropriate segregation of duties is to have no one individual perform any tasks in more than one of the following four duties:
 1. Custody of assets
 2. Record keeping
 3. Authorization of transactions
 4. Reconciliation

Separation of Duties

- Example for cash receipts transaction cycle when four (4) individuals are available:

Employee A	Employee B	Employee C	Employee D
<ol style="list-style-type: none">1) Approves invoices for mailing2) Records cash receipts in GL3) Enters account adjustments into GL4) Completes monthly bank reconciliation	<ol style="list-style-type: none">1) Receives cash2) Reconciles cash drawer daily	<ol style="list-style-type: none">1) Completes daily bank deposit slip2) Authorizes account adjustments to be entered in GL3) Prepares annual budget	<ol style="list-style-type: none">1) Approves billing rates2) Approves annual budget3) Initiates any interbank transfers4) Reviews monthly bank reconciliation and support5) Reviews monthly financial statements, including actual to expected variances

Separation of Duties

- Example for cash receipts transaction cycle when three (3) individuals are available:

Employee A	Employee B	Employee C
<ol style="list-style-type: none">1) Approves invoices for mailing2) Records cash receipts in GL3) Enters account adjustments into GL4) Completes monthly bank reconciliation	<ol style="list-style-type: none">1) Receives cash2) Reconciles cash drawer daily3) Prepares annual budget	<ol style="list-style-type: none">1) Completes daily bank deposit slip2) Authorizes account adjustments to be entered in GL3) Approves billing rates4) Approves annual budget5) Initiates any interbank transfers6) Reviews monthly bank reconciliation and support7) Reviews monthly financial statements, including actual to expected variances

Separation of Duties

- Example for cash receipts transaction cycle when two (2) individuals are available:

Employee A	Employee B
<ol style="list-style-type: none">1) Approves invoices for mailing2) Receives cash3) Records cash receipts in GL4) Enters account adjustments into GL5) Completes monthly bank reconciliation	<ol style="list-style-type: none">1) Reconciles cash drawer and completes bank deposit slip daily2) Authorizes account adjustments to be entered in GL3) Approves billing rates4) Prepares and approves annual budget5) Initiates any interbank transfers6) Reviews monthly bank reconciliation and support7) Reviews monthly financial statements, including actual to expected variances

Potential Issues

- Larger staff for proper segregation of duties:
 - Cost due to additional salaries
 - Proper staff utilization (down-time)
- Fewer staff members:
 - Increases potential for collusion between individuals
 - Difficult to rotate job duties or mandate vacation leave
 - Too many job functions distracting individuals from proper internal controls
 - Fewer individuals to observe what is occurring on a day-to-day basis

Possible Alternatives

- When proper segregation of duties is not feasible, possible alternatives could include:
 - ❑ Board involvement
 - ❑ System required approvals and restricted access capabilities
 - ❑ Cross-training existing staff to perform all basic tasks
 - ❑ Involvement of individuals from other departments
 - ❑ Outsourcing functions

Board Involvement

- Board member involvement could include:
 - Development of accurate budget amounts for both receipts and disbursement accounts at a level to permit appropriate analysis.
 - Comprehensive review of checks written, noting nature and vendor.
 - Monthly review of actual results in comparison to developed budgetary amounts with appropriate inquiry and follow-up to resolve noted discrepancies and issues.
 - Secondary check signer for amounts exceeding established thresholds.
 - Review of monthly bank reconciliations and supporting document prepared by staff.

IT System Controls

- IT System Controls could include:
 - Pre-established hierarchy of approval for purchases as well as payroll data.
 - Access controls which restricts individuals to system capabilities necessary to complete their assigned tasks.
 - Provide on-line financial information to department heads for on-going monitoring of financial performance.
 - Require on-line adjustments to accounts or journal entry to provide on-line trail of who made the adjustment and nature for adjustment.

Cross-Training

- Cross-training staff could include:
 - Provide necessary training to enable other individuals to perform various tasks in case of emergencies or cover vacation leave.
 - Train other individuals to review certain accounting functions, including established vendors and payroll data processed.
 - Provide necessary information for individual(s) to establish new vendors and employees within the system and restrict access to individual responsible for processing payments.

Other Departments

- Involvement from other departments could include:
 - Make departments responsible for mailing customer invoices.
 - Require department approval on all vendor invoices prior to enabling payment process.
 - Have departments mail out delinquency notices and follow-up on outstanding accounts to ensure all payments have been properly received and recorded.
 - Require direct supervisor approval on all payroll and attendance information prior to processing.

Outsourced Functions

- Controls which could be outsourced include:
 - Utilization of lockbox function at financial institution eliminating the access to cash.
 - Hire an independent accountant to perform the monthly reconciliation and perform high-level review of cash transactions.
 - Use of payroll processing or independent billing company in which information is uploaded automatically in general ledger.
 - Use of positive pay feature where final payment approval is approved by someone other than individual processing disbursement.

Payroll Case

FACTS:

Village Clerk was only individual that was responsible for processing, entering, and paying employee payroll. Monthly budget to actual statements were provided to the Village Board quarterly at the functional level (general government, security of persons, etc.). During the year, the Clerk started paying herself a “stipend” of \$1,000 per month and then \$2,500 per month, in addition to her established salary for performing her duties. Over 3-year span, she overpaid herself nearly \$50,000.

POTENTIAL CONTROL(s):

What controls would have likely detected this if they were in place?

Disbursement Case

FACTS:

Village Administrator was responsible for authorizing purchases as well as being the official purchasing officer for the Village. During four (4) year period, the Administrator charged nearly \$225,000 of personal expenses to the Village credit card. Total non-payroll related expenditures for the period amounted to just over \$1.0 million.

POTENTIAL CONTROL(s):

What controls would have likely detected this if they were in place?

Receipt Case

FACTS:

Village Utility Clerk was only individual that was responsible for billing, collection, depositing, and recording utility receipts. Over a four (4) year period, the Clerk was able to misappropriate over \$200,000 by overstating the amounts posted to the general ledger compared to those deposited into the Village's bank account on a monthly basis.

POTENTIAL CONTROL(s):

What controls would have likely detected this if they were in place?

Reconciliation Case

FACTS:

Same facts as the receipts case presented above. It should be noted there was no reconciliation of cash balances per bank to the cash balances reported within the Village's general ledger. Furthermore, the Utility Clerk was responsible for monitoring and addressing delinquent utility accounts.

POTENTIAL CONTROL(s):

What controls would have likely detected this if they were in place?



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BUSINESS ADVISORS

QUESTI[✳]IONS?

Larry Weeks, CPA

Shareholder

937.399.2000

lweeks@cshco.com