SEPARATION OF DUTIES

Internal Control

- A process put in place by the governing body, management, or others, to provide:
  - Consistent and reliable operations; and
  - Reasonable assurance that funds will be properly safeguarded.
Separation of Duties

- Ideally, the following should be separated:

  - Authorization
  - Custody of Assets
  - Record Keeping
  - Reconciliation

Separation of Duties - Small Organizations

- When an entity has a small number of staff and each responsibility cannot be separated, weaknesses can be mitigated by a secondary review or approval.
Happy Tree City
Key Controls Receipting

• Cash/checks received by cashiers are issued a receipt auto generated by receipting system.
• Bank reconciliation performed by the Business Administrator.
• Detailed monthly financial reports reviewed by council and mayor.

Happy Tree City
Key Controls Disbursing

• All checks are reviewed/signed by the mayor and council member.
• Bank reconciliation performed by Business Administrator.
• Detailed monthly financial reports reviewed by council and mayor.
Happy Tree City – Key Controls

Auditor Conclusion:
Material errors will be caught in bank reconciliation or review of financial reports by council and mayor. Controls are adequate.

- Do we have all the information needed for that conclusion?

What about Separation of Duties?

Who has access to cash/checks – where is it stored?
Who has access to the bank accounts?
Who has a purchasing card?
Who has access to blank checks?

Authorization → Custody of Assets → Record Keeping → Reconciliation

Who records transactions in the GL?
Who prepares the monthly reports?
Happy Tree City – Custody of Assets

• Who has access to cash/checks – where is it stored?
  – Cashiers
  – Access to safe – Cashiers, Business Administrator, Mayor
  – Takes deposit to bank – Business Administrator

• Who has access to the bank account?
  – Authorized signors – Mayor/Council members

Happy Tree City – Custody of Assets, con’t

• Who has a purchasing card?
  – One card, anyone can use. Maintained by Business Administrator

• Who has access to blank checks?
  – Kept in locked drawer. Mayor and Business Administrator have key.
Happy Tree City – Record Keeping

• Who records transaction in the GL?
  – Cashiers
  – Business Administrator

• Who prepares the monthly reports?
  – Business Administrator

Happy Tree City Separation of Duties

Authorization/ Final review of processed transactions? → Custody of Assets → Record Keeping → Reconciliation

Council/Mayor → Business Administrator, Mayor → Business Administrator
Happy Tree City – Separation of Duties Issues

• Mayor has access to cash in safe, signs checks and has access to bank account and blank checks.

• What could go wrong?
  – could issue checks, take cash or transfer bank funds for personal gain.

• Compensating Control?
  – Yes, Mayor does not have access to GL and bank reconciliation is performed by Business Administrator.

Happy Tree City – Separation of Duties Issues

• Business Administrator has access to cash/checks in safe and deposits, has access to purchasing cards and blank checks, records transactions in GL, performs bank reconciliation, and prepares monthly reports for council and mayor.

• What could go wrong:
  – Take cash or issue check or use purchasing card and conceal the transaction in GL, bank reconciliation, and monthly report.
Happy Tree City
Separation of Duties

• Auditor conclusion still correct?
  – Material errors will be caught in bank reconciliation or review of financial reports by council and mayor.

• NO – separation of duties finding should be issued relating to the Business Administrator

Separation of Duties
Separation of Duties

• How do you think about it? Just keep it in the back of your mind when thinking about controls?

• Ask only one question? Is there adequate segregation of duties among those who:
  - Collect accounts receivable.
  - Open the mail or copy checks received.
  - Prepare deposits.
  - Deposit cash receipts.
  - Enter transactions into the GL
  - Initiate checks for expenditures.
  - Review, authorize, or sign checks.
  - Review the receivables aging trial balance.
  - Authorize write-offs of delinquent accounts.
  - Investigate discrepancies or issues related to expenditures, inventory, capital assets, revenue, debt, or cash.
  - Reconcile bank accounts.

Separation of Duties
Gaining an Understanding

• Talk with multiple people.
  - Who handles checks/cash?
  - Who reconciles original receipting records to the GL or bank statement?
  - Who has access to where funds are stored?
  - Who has access to blank checks? Or to the check generating system?
  - Who has access to enter transactions in the GL or subledgers?
  - Ask more than ‘Do YOU have access’.

Office of the
Utah State Auditor
Separation of Duties
Gaining an Understanding

• Stop asking only yes or no answer questions!

• Consider sending a questionnaire to the client to complete.
  – List who does what
  – Describe specific duties

Separation of Duties
Gaining an Understanding

• Observe multiple documents.

Trust, but verify!
## Separation of Duties Considerations

<table>
<thead>
<tr>
<th>Duty</th>
<th>Consideration</th>
</tr>
</thead>
</table>
| Bank Reconciliation         | Does the employee performing the bank reconciliation also have any of the following responsibilities?  
                              | • Receiving cash/checks  
                              | • Preparing deposits  
                              | • Generating or printing checks  
                              | • Executing or authorizing wire transfers  
                              | • Check signor  
                              | • Access to blank check stock  
                              | • Access to NSF checks |

<table>
<thead>
<tr>
<th>Duty</th>
<th>Consideration</th>
</tr>
</thead>
</table>
| Handling or access to cash receipts | • Are original receipting records reconciled bank records? Reconciliation of licenses issues to amounts deposited?  
                              | • Where are cash/check receipts stored? Who has access?  
                              | • Who takes the deposit to the bank?  
                              | • Who has access to the bank accounts? What kind of access?  
                              | • Who handles NSF checks? |
Separation of Duties Conflicts

- Handles Checks/cash
- Prepares Billings

Employee could take cash and stop subsequent billings or write off account

Separation of Duties Considerations

<table>
<thead>
<tr>
<th>Duty</th>
<th>Consideration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Review of Processed Disbursements</td>
<td>• What is being reviewed? Detail or Summary?</td>
</tr>
<tr>
<td></td>
<td>• Who is preparing the detail?</td>
</tr>
<tr>
<td></td>
<td>• How is the information prepared? Auto generated by reviewer? Access to GL to view?</td>
</tr>
<tr>
<td></td>
<td>• Who is reviewing processed disbursements and JEs?</td>
</tr>
<tr>
<td></td>
<td>• Original documents?</td>
</tr>
</tbody>
</table>
Compensating Controls

Weaknesses can be mitigated by a secondary review or approval.

- Independent detailed review of original bank statement and bank reconciliation.
- Independent detailed review of GL transactions.
  - Does the reviewer have the SKE to perform review?

Separation of Duties

- Separating responsibilities so that no one individual has the ability to improperly use money without detection.

- How to document consideration of separation of duties?
Separation of Duties
How to Document

• Checklist – yes/no:
  Is there adequate segregation of duties among those who:
  - Collect accounts receivable.
  - Open the mail or copy checks received.
  - Prepares and deposits cash receipts.
  - Deposit cash receipts.
  - Enter transactions into the GL
  - Review, authorize, or sign checks.
  - Reviews the AR listing.
  - Authorize write-offs of delinquent accounts.
  - Investigate discrepancies or issues related to expenditures, inventory, capital assets, revenue, debt, or cash.
  - Reconcile bank accounts.

• Alternative Option – Provide client with list of duties and asking for a corresponding list of who does what. Investigate conflicts

Separation of Duties
How to Document

• Matrix – OSA Example

<table>
<thead>
<tr>
<th>Names and Duties</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
<th>F</th>
<th>G</th>
<th>H</th>
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<tbody>
<tr>
<td>Accountant</td>
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<td>Council Member</td>
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</table>

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Materiality Reminder

More than just a number.....

**GAO 4.47** - “... in audits performed in accordance with GAGAS, auditors may find it appropriate to use lower materiality levels as compared with the materiality levels used in non-GAGAS audits because of the public accountability of government entities and ... the visibility and sensitivity of government programs.”
Materiality in Recent Frauds

Kane County

<table>
<thead>
<tr>
<th>Misappropriation</th>
<th>Materiality</th>
</tr>
</thead>
<tbody>
<tr>
<td>• $100,000 over 3 years</td>
<td>• GF Revenues – $8 million</td>
</tr>
<tr>
<td>• $33,000 a year</td>
<td>• GF PM - $230,000</td>
</tr>
<tr>
<td>• 0.41% of annual GF Revenues</td>
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</tr>
</tbody>
</table>

Separation of Duties
Experience Matters

- Train staff on specific conflicts - what can go wrong?
- Provide examples.
- Discuss compensating controls.
QUESTIONS?

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patricianelson@Utah.gov