

SEGREGATION OF DUTIES AND FINANCIAL OVERSIGHT

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TOPICS

- Segregation of Duties
- Internal Controls
- Financial Oversight
- Cybersecurity

SEGREGATION OF DUTIES AND FINANCIAL OVERSIGHT

- What are segregation of duties?
 - Segregation of Duties (SOD) is a basic building block of sustainable risk management and internal controls for an organization. The principle of SOD is based on shared responsibilities of a key process that disperses the critical functions of that process to more than one person or department. Without this separation in key processes, fraud and error risks are far less manageable.
 - One of the key concepts in placing internal controls over a company's assets is SOD, which serves two key purposes: It ensures that there is oversight and review to catch errors. It helps to prevent fraud or theft because it requires two people to collude in order to hide a transaction.
 - SOD should be designed so the work of one individual is constantly being reviewed by another individual.
 - The person handling the asset should not be the same person who is recording the transactions.

CASE STUDY #1

- Background:
 - Organization A provides counseling services to individuals and children. The organization generates revenue by providing these counseling services and then collecting payment for the services from either insurance companies or the individuals.
 - The Organization's employees are hourly except for the Executive Director and Controller who are salaried.
 - The organization currently has three individuals who work in the main office. The three individuals are the Executive Director, Controller and Administrative Assistant. All positions are full-time.

CASE STUDY #1

➤ Cash Receipts:

- The organization receives cash in the form of checks for services performed from insurance companies and individuals. The organization does have some individuals who pay in cash at the time of service.
- To provide efficiency in processing payments, the Administrative Assistant receives all cash (checks and currency) payments. The Administrative Assistant provides the cash to the controller who counts the cash, prepares the deposit ticket, makes the deposit, and posts the payments to the respective client accounts. Receipts of currency are only deposited in the bank once every other week. Checks are deposited daily using remote access. This system allows the Executive Director and Administrative Assistant time to perform their duties without being involved in the day to day fiscal affairs.

CASE STUDY #1

➤ Cash Disbursements:

- All mail is opened by the Administrative Assistant. Any invoices for payment are sent to the Controller. The Controller posts the invoices to the books and records, determines which vendors are to be paid, prepares the checks, signs the checks, and mails the payments. This system allows the Executive Director and Administrative Assistant time to perform their duties without being involved in the day to day fiscal affairs.

➤ Payroll:

- Employee time sheets are forwarded to the Controller. The Controller generates the pay checks and transfers money from the general checking account to the payroll account to cover the net pay and related tax payments. The Executive Director signs the checks and returns to the Controller so they can distribute the checks to the employees.

CASE STUDY #1

- Month End Closing Process:
 - The Controller reconciles all balance sheet accounts including the cash accounts. The Controller prepares a balance sheet as of month end and a month and period to date profit and loss statement comparing the current period actual to the prior period actual and the current period actual to the current period budget. Sometimes the Controller is several months behind in this process.
 - The Executive Director and Board of Directors review these reports in detail at the bi-monthly meetings.

CASE STUDY #1

- ***What, if any, changes are needed to this system???***
- Properly Designed System –
- Cash Receipts:
 - Administrative Assistant receives all cash and checks.
 - The Administrative Assistant maintains a log of all payments received ALTERNATIVELY receive the payments and apply to the client's accounts.
 - The Administrative Assistant provides the cash and checks and documentation to the Controller.
 - The Controller counts the cash and prepares the deposit ticket ALTERNATIVELY the controller could prepare the deposit ticket and post the payments to the client's accounts.
 - The Executive Director verifies the cash receipts log maintained by the Administrative Assistant with the deposit prepared by the controller. The Executive Director makes the deposit of cash and checks on a daily basis.

CASE STUDY #1

- ***What, if any, changes are needed to this system???***
- Cash Disbursements:
 - All mail is opened by the Administrative Assistant.
 - All invoices are forwarded to the Executive Director to approve for payment.
 - The Controller posts all invoices approved by the Executive Director to the books and records of the Organization.
 - The Controller prepares checks for the Vendors to be paid. The checks and the supporting documents are provided to the Executive Director.
 - The Executive Director and another Officer/Board Member sign all checks.
 - The Executive Director provides the signed checks to the Administrative Assistant to mail.

CASE STUDY #1

- ***What, if any, changes are needed to this system???***
- Payroll:
 - All time sheets are forwarded to the Executive Director for approval.
 - The Executive Director provides the approved time sheets to the Controller to calculate the payroll.
 - The Controller processes the checks for payment. The Controller initiates the transfer of funds from the general account to the payroll account to cover the employee net pay and payroll taxes. The Executive Director corroborates the transfer of funds by responding to an e-mail generated by the Organizations financial institution.
 - The Controller provides the employee pay checks to the Executive Director for signature.
 - The Executive Director gives the signed checks to the Administrative Assistant for distribution to the employees. Any unclaimed checks are provided to the Executive Director to follow up with the employee.

CASE STUDY #1

- ***What, if any, changes are needed to this system???***
- Month End Closing Process:
 - The Controller reconciles all balance sheet accounts including the cash accounts.
 - The cash account reconciliations are reviewed by the Executive Director or an officer of the Board of Directors on a monthly basis.
 - The Controller prepares a balance sheet as of month end and a month and period to date profit and loss statement comparing the current period actual to the prior period actual and the current period actual to the current period budget.
 - The Executive Director reviews the reports with the Controller prior to the Governing Board Meeting. Should reports not be prepared timely, a course of action for preparing the reports is agreed to with the Controller. (This should not be a surprise to the Executive Director)
 - The reports are shared with the Board of Directors and their comments are addressed at the meeting or shortly thereafter.
- What makes a good internal control system – Segregation of Duties is only part of the Financial Control of an organization.

CASE STUDY #2

- Land development entity that employs 500+ individuals. The organization's management consists of a Chief Executive Officer (CEO), Chief Financial Officer (CFO), VP of Human Resources and a VP of Enterprise Development.

CASE STUDY #2

➤ Payroll:

- New hires are initiated by supervisor who place help wanted ads and interview prospective candidates. All new hires are approved the supervisor and the VP of Human Resources. The new employees information is provided to a payroll specialist to set up the employee to be paid.
- Time sheets for employees are approved by the employees supervisor and forwarded to the Payroll Specialist to enter their time worked. The Payroll Specialist processes the employees' pay every two weeks. Employee pay is primarily distributed via direct deposit with a few employees receiving checks. Checks are distributed by the Administrative Assistant to the President. Any checks not claimed are returned to the payroll specialist to follow up.

CASE STUDY #2

- ***What, if any, changes are needed to this system???***
 - New employee information should be entered into the system by someone other than the Payroll Specialist. The Payroll Specialist should have read-only access to the employee information.
 - The Payroll Specialist should enter employee time and can process the payroll. The Direct Deposit distribution should be reviewed by a management level employee to ensure employee pay is reasonable. May not be able to catch errors given the number of employees but ensure it looks reasonable. Use of the payroll system to identify exceptions can help provide control over this process)
 - Any pay checks not distributed should be provided to a management employee to follow up on the reason the pay check was not picked up.

CASE STUDY #3

- Manufacturing facility that produces fabricated housing.
- The operation has a significant inventory of raw material for the manufacturing process, as well as an inventory of the prefabricated houses.
- Currently shipments of raw material are received at two locations. One on site and another three blocks away at a former location. The location is determined based on which tow motor operator is available. There is no stated receiving location for the inventory.

CASE STUDY #3

- All receiving reports are collected by the inventory foreman and forwarded to the plant accounting department to track the receipts.
- When raw material inventory is requested, the Inventory Foreman is contacted and a transfer form is created by the inventory foreman. This form is forwarded to the accounting department to relieve the raw material inventory.
- In order to allow employees to enjoy the year-end holidays, the organization ceased doing physical count of inventory many years ago.

CASE STUDY #3

➤ *How can the process be improved?*

- Establish one location and inform vendors all shipments should be made only to that location.
- Inventory Foreman should not be approving receipts and distribution of items. Suggest someone from the production process approve the release of inventory for the manufacturing process.
- Institute a year-end inventory count or perform a rolling inventory count, whereby all items are counted at least once a year.

INTERNAL CONTROL

Key concepts:

Internal control is a *process*. It is a means to an end, not an end in itself.

Internal control is affected by *people*, not just policy manuals and forms.

Internal control can be expected to provide only *reasonable assurance*, not absolute assurance.

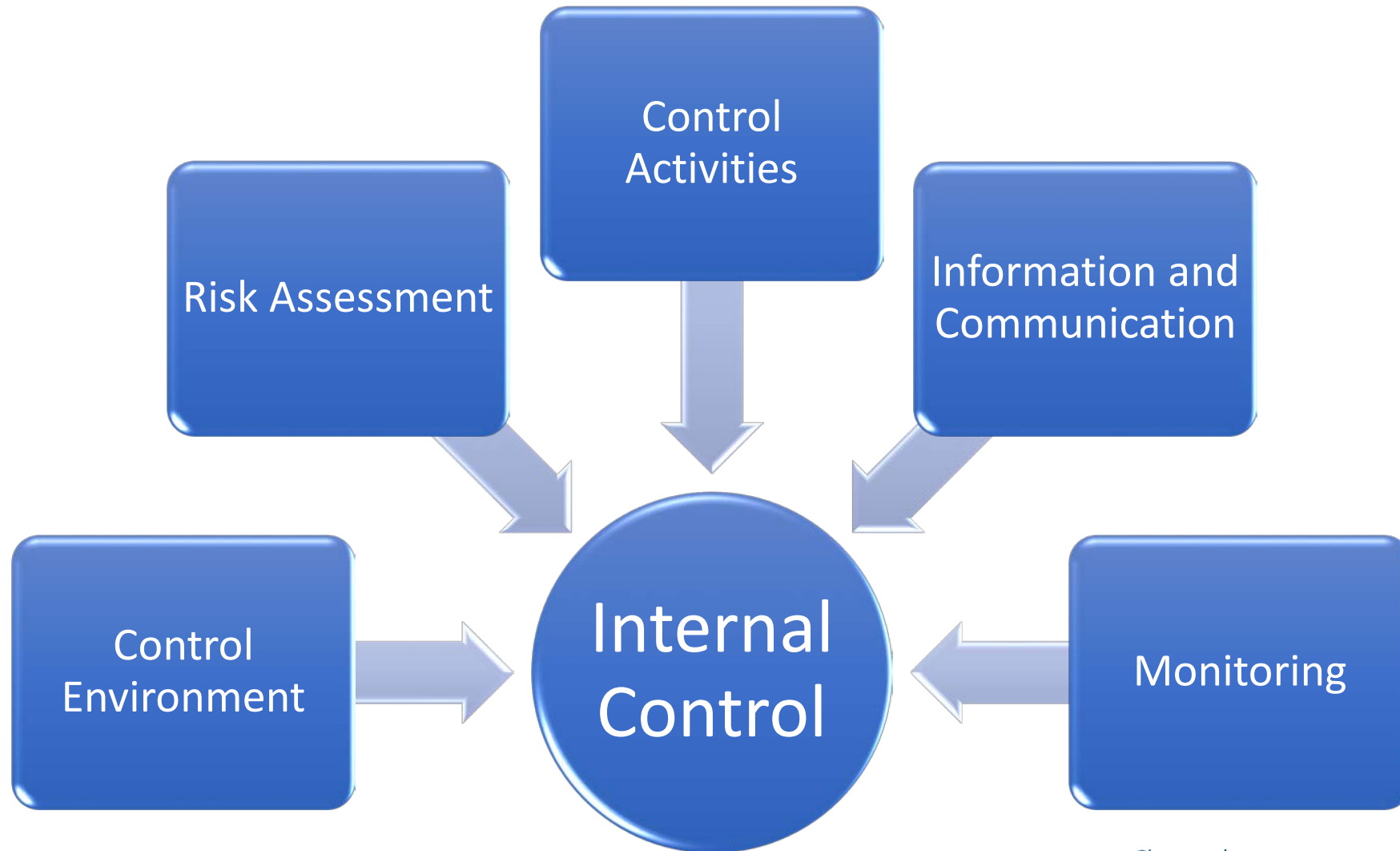
There are three types of internal controls:

Preventive

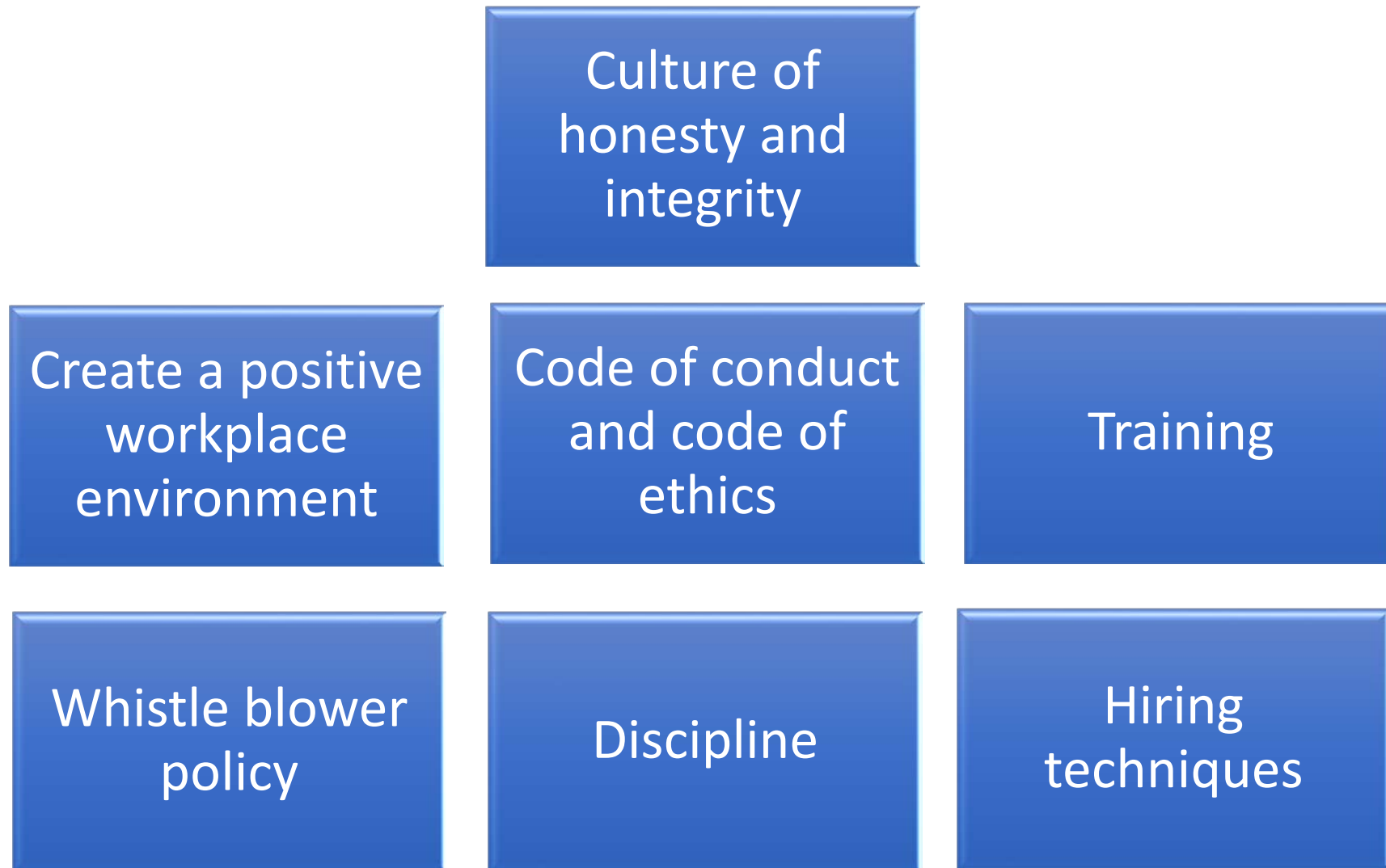
Detective

Corrective

INTERNAL CONTROL



CONTROL ENVIRONMENT – “TONE AT THE TOP”



CONTROL ENVIRONMENT

- Practical Application
 - Establish an anonymous whistle blower policy
 - Establish current policies with regard to ethical behavior (code of conduct), conflict of interest, nepotism
 - Enforce appropriate discipline for failure to comply with these policies and procedures
 - Ensure personal adherence to strong moral code
 - Reward competency
 - Place high degree of importance on maintaining strong internal control
 - Require mandatory vacation in which someone else completes all duties

CONTROL ENVIRONMENT

- Maintaining a Qualified Staff
 - Competent and honest staff
 - Up to date job descriptions
 - Follow appropriate hiring policies (not hiring a relative or friend)
 - Assign authority and responsibility
 - Ensure that employees are trained appropriately
 - Review and document performance
 - Set appropriate performance goals on an annual basis

RISK ASSESSMENTS

A risk assessment is a critical and essential component in the entity's evaluation. It must consider ways that errors, irregularities, fraud, and misconduct can occur against the entity by employees, vendors and/or customers.

Identify
risks

Estimate
the
significance
of the risk

Assess the
likelihood
of the risk
occurring

Mitigation
= Internal
Controls

CONTROL ACTIVITIES

Polices and procedures that ensure management directives are carried out

- Top-level reviews
- Operating performance indicators/reviews
- Reconciliations
- Security of assets
- Segregation of duties

INFORMATION AND COMMUNICATION

Ensures that
information is
accurate and
communicated
timely

- Internal and external interactions
- Pertinent information to be identified, captured and communicated
- Information communicated timely for employees to carry out their responsibilities
- Reports must contain relevant operational, financial and compliance information

INFORMATION AND COMMUNICATION

- Communication with Board of Directors
 - Discussion of any unusual transaction
 - Budget to Actual report by budget line
 - Explanations for variances over a certain threshold

MONITORING

Ensures
that
internal
control
continues
to operate
effectively

- Assesses the quality of the internal control system
- Makes modifications as necessary
- On-going process through normal operations

MONITORING

- Constant Review
 - Determine whether the internal control system continues to be relevant and is able to address new risks.

MONITORING - EXAMPLES

- Bank Reconciliations
 - Performing a review of bank reconciliations on a monthly basis and signing off as having reviewed these (review to be completed by someone other than the preparer).
- Cash Receipts
 - Monthly comparison of actual receipts to budget receipts.
 - Regularly selecting a few transactions to ensure proper recording.
- Cash Disbursements
 - Monthly comparison of actual disbursements to budgeted expenses.
 - Reconciliation of procurement card purchases by someone other than the card holder.
 - Regularly selecting a few transactions to ensure proper recording.

MONITORING – PRACTICAL APPLICATION

- Controls will change as makeup of account/transactions change.
- Policies and procedures should be reviewed annually, at a minimum.
- Controls should be evaluated when there are changes in key personnel or changes in software applications.

INTERNAL CONTROL

- Establish written policies and procedures that are communicated to employees on a regular basis.
- Ensure that policies and procedures are followed.
- Be sure to tailor any “borrowed” policies and procedures to your District.
- The cost of implementing a control structure should not outweigh the benefits (i.e. hiring an individual just to be a second signer on a check).

FINANCIAL OVERSIGHT

- Financial Oversight begins with Board of Directors, followed by Senior Management.
- The Board of Directors need to set the tone for requiring accurate and timely financial reporting.
- The Board of Directors need to determine what financial information is needed to perform their fiduciary duties.
- The Executive Director – Ensures the Board of Directors receive the financial information requested.
- The Executive Director – Ensures all information related to the financial welfare of the organization is disclosed to the Board of Directors

FINANCIAL OVERSIGHT

- Chief Financial Officer – Responsible for producing accurate and timely reports for the board of directors and management to use.
- Controller – Responsible for the accuracy of the reports and ensuring supporting staff gather the necessary information to produce accurate reports.

FINANCIAL OVERSIGHT

- What reports should be provided (minimum)?
 - Balance Sheet as of month end
 - Statement of Profit and Loss comparing current period actual to the prior period actual and to the current period budget.
 - Suggest reporting of results by month and year to date.
 - Suggest preparing budget by month.
 - Suggest making the Board of Directors aware of any tax filings when they occur. Such as reviewing the Federal Form 990 for Tax Exempt Entities.

CYBERSECURITY ISSUES

- Types of attacks that could occur:
 - Denial of service attacks
 - Phishing and spear phishing attacks
 - Malware attacks
 - Ransom ware attacks

CYBERSECURITY ISSUES

- Basic procedures to combat this:
 - Forced password changes with some frequency (Quarterly)
 - Update software regularly with patches
 - Maintain most current version of anti-virus software
 - Maintain backups of system files
 - Training of employees with regard to cyber threats
 - Penetration testing of system
 - Dual Authentication Access
 - Secure WiFi – Non-Broadcasting internal and guest
 - Bit Lockers on the hard drive
 - Ensure Cloud Computing providers are reputable
 - Secure e-mail

Q&A

ABOUT THE SPEAKER



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28 years of experience, including audits of local government and not for profit organizations

ABOUT THE FIRM

- The leadership and services local governments provide are the foundation of strong communities.
- SEK&Co Governmental Services Team understands the unique accounting and operational issues within the industry.
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