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Segregation of Duties

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S.o.D. Definition

Green Book Defines Segregation of Duties (S.o.D.) as:

- Process where management divides or segregates key duties and responsibilities among different people to reduce the risk of error, misuse, or fraud. So that no one individual controls all key aspects of a transaction or event, this includes separating the responsibilities for:
 - authorizing transactions,
 - processing and recording them,
 - reviewing the transactions,
 - and handling any related assets
- Other areas within the Green Book with S.o.D. mentions:
 - Overview(OV), 3.08, 8.07, 10.12-14,11.07, 11.12, 11.14



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What's wrong? NOTHING'S WRONG!



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Examples of what went wrong:

Village School District:	• \$661,766
City School District:	• \$4.2 million
County:	• \$3 million
Community School:	• \$1.2 million
Village:	• \$677,000



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How?

- Self issued checks
- Fraudulent employees added to payroll
- Failure to deposit receipts properly
- Improper related party relationships
- or similar schemes



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Self-issued Checks

- Who:**
 - Fiscal Officer (or delegate)
- How they get away with it:**
 - They have access to write checks to themselves
 - They are the only record keeper, and can make the expenditure appear legitimate in accounting system.
 - They are the only monitor, they perform the bank to book reconciliation
- Solutions:**
 - Segregation of the above roles and/or close monitoring by others.



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Fraudulent Employees in Payroll system

Who:

- Fiscal Officer, Payroll clerk (or other designee)

How they get away with it:

- They are the only ones with access to enter new employees
- They are the only record keeper, able to write checks to whomever they chose
- They perform the bank to book reconciliation

Solutions:

- Segregation of the above roles and/or close monitoring by others.



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Failure to deposit receipts properly

Who:

- Anyone who receives money

How they get away with it:

- They reconcile daily receipts to pay-in/receipt documents
- They record activity into the accounting system

Solutions:

- Segregation of the above roles and/or close monitoring by others.



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Improper related party activity

Who:

- Employee in the accounting cycle who also is employed with an entity that the gov't does business with (i.e. boosters, vendors, etc..)

How they get away with it:

- Lack of controls at the related entity allow for improper invoicing or check writing
- Lack of oversight/scrutiny in handling of activity by the government

Solutions:

- Segregation of the above roles and/or close monitoring by others.
- Scrutiny/oversight of ALL related party activity



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Overview

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Overview of control process

- Overview section of the Green Book (<http://www.gao.gov/greenbook/overview>)
 - (OV)1.04 An internal control system is a continuous built-in component of operations, effected by people, that provides reasonable assurance, not absolute assurance, that an entity's objectives will be achieved
- The five components of internal control are
 - Control Environment
 - Risk Assessment
 - Control Activities
 - Information and Communication
 - Monitoring

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Various Standards

- AU-C 240
 - Inadequate segregation of duties or independent checks increases the susceptibility of misappropriation
- AU-C 265
 - Absent or inadequate S.o.D may be deficiencies, significant deficiencies, or material weaknesses
- AU-C 315
 - Should reduce the opportunities to allow any person to be in a position to both perpetrate and conceal errors or fraud
- OAC 117-2-04(D)(4)
- And on and on and on.....



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In order to audit S.o.D we need:

An adequately updated understanding of the process

- How: AOS addresses this through narratives
- When: Beginning of the audit
- Why: Provides basis for further testing

Effective communication

- How: Face-to-face, electronic, policies
- When: Throughout engagement
- Why: Consistent approach



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Benefits are not mutually exclusive



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How to make S.o.D a focal point



Evaluation



Documentation



Communication





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Evaluation

Audit Strategy

- Discussion among audit Staff Members
- Discussion at pre-audits if needed
- Walk through of processes

Local Gov't

- Analyze internal control processes
 - Who is doing what
 - What are the possible risks



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Documentation

Auditors

- Discuss and complete narratives
- Segregation of Duties Matrix
- Utilize narratives to tailor audit procedures

Local Gov't

- Detailed policies and procedures
- Audit trail
- Evidence of implementation of controls



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Communication

Auditors

Local Gov't

- Planning discussions
- Inquiries during the audit
- Audit report

- Provide policies to all staff
- Update them regularly throughout the year
- Discuss known/identified issues with auditors



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How AOS will evaluate S.o.D

- Tool/practice aid to systematically evaluate *S.o.D*
- Spreadsheet which documents all processes in a given cycle along with the auditee staff individual responsible for completing it
- Primary cycles it will be used for include:
 - Self-assessed Taxes
 - Charges for Services
 - Over the Counter Receipts
 - Payroll Disbursements
 - Non-Payroll Disbursements
 - Capital Assets/Inventory
 - Bank/Investments



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When might there be an issue?

Any time an individual is serving in more than one of the key roles

- authorizing transactions,
- processing and recording them,
- reviewing the transactions,
- and handling any related assets

AND

- No compensating controls are in place



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Compensating Controls

Definition:

- A control that can limit the severity of a deficiency and prevent it from being a material weakness. Although they can mitigate the severity, they do not eliminate the deficiency.

Examples:

- Review of **detailed** reports
- Review/reperform reconciliation procedures
- Review/approve any adjustments (i.e. non-cash adj)

Caution:

- If compensating controls are monitoring controls
- Evaluate they are adequate.



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Compensating Controls

If there are no SOD issues

- No compensating controls are necessary

SOD issues exist with effective compensating controls

- Evidence of the compensating control is needed

Identifiable issues w/o appropriate compensating controls

- A fraud risk exists
- An audit issue/ comment is likely needed
- If risk is significant, auditors may need to change the audit plan



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What are significant risks?

Risks may be determined as significant if:

- The accounting cycle is material
- Absent/inadequate safeguards
- Auditor judgment

If risks are significant, our audit reactions may include:

- No reliance on prior year control tests
- Additional management involvement in audit
- More sampling tests



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Does it mean there is fraud?

Difference between fraud *risk* and fraud.

- Evidence of a fraud risk area does not necessarily indicate fraud has occurred.
- We may modify the nature, timing and/or extent of our procedures in response to any heightened fraud risks identified.

Important to keep in mind that each case or scenario is different.

- Each potential fraud is unique, even within the same schemes.
- Many factors determine the handling and ultimate outcome of the issue.
- There is no black and white "rule book" or checklist.



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What should local gov't do?



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Establish Policies/procedures

Put it in writing:

- Could be formal Ordinances or resolutions, or
- Could be policy manuals or handbooks

Why?

- Formal way to ensure everyone is on the same page
- Written documentation can assist in identifying weaknesses or potential SOD issues
- Assists in the event of an emergency



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Establish Internal Controls

Internal Control System

- Controls should exist to prevent, detect, or deter misstatements or errors
- i.e. – sign-offs/approvals, reconciliations/reviews, etc..

Segregation of Duties

- Evaluate who is doing what, and consider whether that has the potential to be an issue
- If so, implement some compensating control to reduce risk

Monitoring Controls

- Board/Admin. Should provide oversight to make sure controls are being followed
- i.e. – evidence of sign-offs/initials, reperformance of reconciliations, etc..



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Communication

Intra-entity

- Evidence should support that policies/procedures are communicated/understood by all
- Reasons for changes to procedures or why controls were overridden should be documented

Inter-entity

- Communication with vendors/related parties should occur at least occasionally
- Communication with auditors to assist in evaluating processes



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Benefits?

Efficient/Effective

- Mitigate the possibility of fraud
- Roles are clearly defined and adhered to
- Lowers the risk of material misstatement

Audit Impact

- Smoother audit through:
 - Less fraud risks
 - More informed auditors



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What if fraud (risks) are identified

- Risks
 - Auditors should ask about fraud during each audit. These should be discussed at that time.
- Actual fraud
 - Law enforcement
 - Fraudohio.com; E-mail
 - 1-866-FRAUD-OH
 - Mobile App: Ohio Stops Fraud
 - News agency, whistleblower
 - Other Agencies (i.e. - ethics commission)
 - Audit team (doesn't need to wait for audit)
 - Regional Liaisons



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Summary

- Importance of evaluating and documenting policies and procedures
 - Strengthens organizational processes
 - Provide staff a better understanding
- Internal controls/ Segregation of duties helps mitigate risks
 - Fraud Risks
 - Financial statement error risks



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Questions



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