

Segregation, Frustration, and Transformation of Duties

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Outline

- Introduction
- The Basics of Segregation of Duties
- The Importance
- The Challenges
- Technology Implications
- Effective Communication
- Suggestions and Examples

Introduction

- The chief element present in occupational fraud is opportunity.
- Inadequate segregation of duties allows fraud to occur and go undetected.
- Inappropriate segregation leads to wasted time and/or ignoring other important internal controls.
- No one would spend \$100 to protect \$80 but poor controls can have the same effect.

Segregation of Duties and Fraud Detection

- According to the *2010 ACFE Report to the Nations* the percent of fraud cases detected by segregation of duties–type controls included:
 - 15.4% Management Review
 - 6.1% Account Reconciliation
 - 5.2% Document Reconciliation
 - 2.6% Monitoring
 - 0.8% IT Controls
- 30.1% Total

Fraud Detection

- Unfortunately, the total detected by internal controls (30.1%) lags far behind tips (40.2%).
- Auditors, police, accidents, and confessions make up the remaining percentage.
- What is not quantifiable is how much fraud is **prevented** by segregation of duties and other internal controls.

Inadequate Segregation Implications

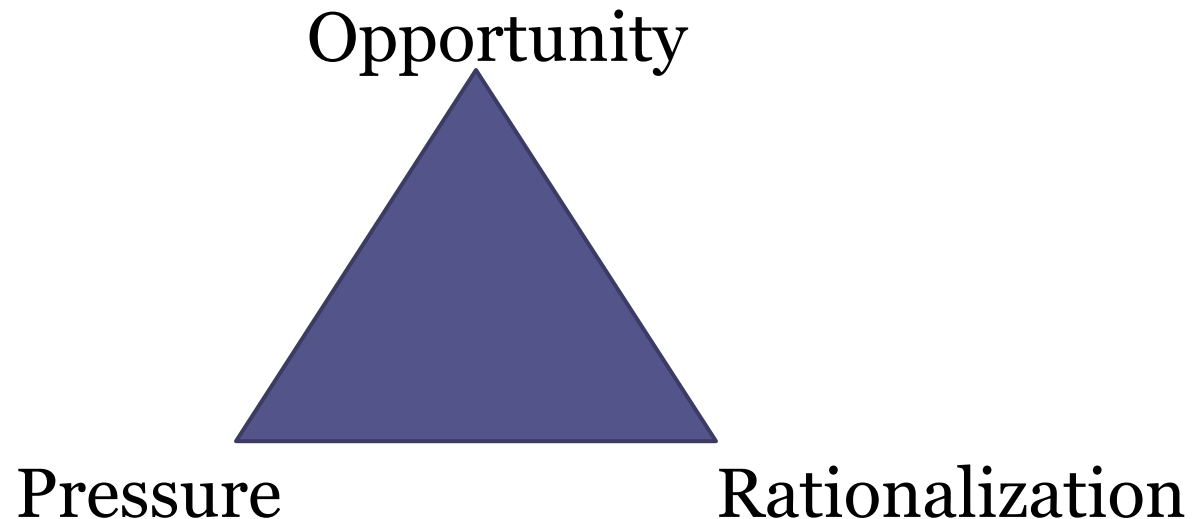
One unfortunately common example

- A bookkeeper in Oregon wrote herself 234 checks on the way to embezzling \$1.5 million. She was sentenced to 24 years in prison. The century-old and family-owned company went bankrupt and 85 people lost their jobs.
- There was no secondary review or reconciliation. The employee was trusted implicitly.

The Basics

- Segregation of duties separate:
 - Authorization
 - Custody
 - Recording
- Segregation forces collaboration to conceal occupational fraud (no lone rangers).
- Segregation empowers multiple employees instead of relying on one.

The Fraud Triangle— Opportunity/Segregation



Opportunity	Pressure	Rationalization
Position	Personal Finances	“I’ll pay it back”
Segregation of Duties	Vices	“I deserve it”

Prevention Versus Detection

- Preventive controls:
 - Stop fraud before it starts
 - Are cheaper to implement
 - May be unrealistic or complicate business processes
- Detective controls:
 - Will not stop fraud
 - Are sometimes the best option

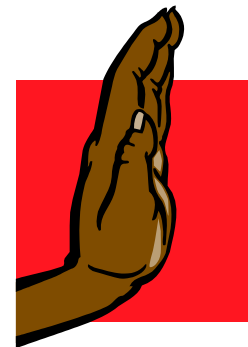
Current Business Environment

- Money is tight for nearly everyone.
- Reorganizations (and layoffs) have become common to improve business health.
- These changes also dramatically change the internal control structure and may eliminate segregation of duties.



Auditors Should Be Part of the Reorganization Conversation

- Auditors cannot only say no ... but should also say how.
- Auditors should communicate the minimum needed to stay protected.
- Controls do not provide absolute assurance.



How Should Fraud Auditors Spend Their Time?

- Investigation—a reactive process that attempts to prove a fraud did or did not occur
- Detection—determine if an investigation should be opened
- Prevention—improving the controls to keep fraud from occurring. Why don't we spend more time on prevention?

What Is the Fraud Auditor's Role?

- It is ultimately to add value.
- It should be more than quantifying fraud losses.
- Evaluating segregation of duties can help reduce frauds and errors.
- The same care and rigor should be given to recommending internal control improvements as was given to the original fraud investigation.
- Eliminate unnecessarily segregated duties that lead to wasted time.

The Auditors Challenge

- Know your environment
 - For instance Higher Education vs. Banking
- Risk of obsolescence for the auditor if they recommend unnecessary controls
- Balance the risk of fraud with the business needs of the organization.



The Magic Bullet

- Good segregation controls depend on the type of business and the compensating controls.
- Cannot rely completely on the segregation of duties grids you find for IT and SOX reviews.
- There is no one-size-fits-all solution.



More Challenges

- Internal controls are not a single act.
- Business processes change and the internal controls inevitably change as well.
- Controls that were essential today can become obsolete tomorrow.
- These complications magnify the importance of having trained internal control professionals.

What Does *Segregation* Mean?

- Segregation of duties does not have one definition.
 - It differs by industry and individual.
- It should be expected that a recommendation to segregate duties will be misunderstood with too much or too little control put in place.

Self-Assessment

- Here is an example of an actual question from a self-assessment tool for managers in Oregon. There are eight different duties that apparently should be performed independently.
 - *No one individual is allowed to control all key aspects of an expenditure transaction, meaning the following responsibilities are performed independently:*
 1. *expenditure authorization;*
 2. *purchasing;*
 3. *receiving;*
 4. *invoice approval;*
 5. *invoice payment;*
 6. *verification and batch release;*
 7. *mailing of checks/warrants; and*
 8. *reviews and reconciliations.*

Technology/ERP Implications

- Enterprise resource planning (ERP) systems are pervasive.
- ERP is a disruptive technology that changes the way we access, input, view, and interact with data.
- ERP has had a significant impact on segregation of duties.



ERP Systems History

- Rush to implement ERP did not allow for adequate consideration of security.
- If you were involved in an ERP implementation you know how much work it took.
- One of the main advantages of ERP was adaptability to each business.
- However, this customization also precluded a universal solution to system access controls.

ERP Systems Security

- IT systems have traditionally focused on external threats.
- As we know, internal threats are significant as well.
- ERP systems were generally implemented without considering segregation of duties or security threats of internal users.

ERP Impact on Segregation

- Increased complexity of ERP systems also increases the fraud risk.
- Individuals may unknowingly have the access to commit a fraud and conceal the event.
- Auditors can no longer base conclusions on signature cards, position descriptions, the physical access employees have, or which department they sit in.

Importance of System Access Reviews

- Not exciting, but as critical as review of physical access
- When not included, the risk of inaccurate audit results is high



Difficulty of System Access Reviews

- ERP security is generally multi-tiered.
- In this adaptable system, access controls can become confusing and cumbersome.
- Access may be granted to a security class or directly in addition to many other security mechanisms.
- Because of these reasons proper access reviews rarely occur.

ERP System Access Reviews

- Ideally, auditors would compare a list of individuals with access to a critical process with access to a conflicting process.
- We do this by using computer-assisted audit techniques (CAAT).
- Once set up, it can be a routine process.
- The risk of false positives and false negatives are high.

Effective Communication

- It is not enough to know the right answer.
- Communication is key.
- Auditors walk the fine line between implementing and recommending.
- Fear of overstepping this line has led to many vague recommendations.



How to Make Value-Added Recommendations

- Time
 - There is not a quick way or a shortcut.
- Effort
 - It is not easy.
- Follow-up
 - Recommendations have a way of being ignored.



Making Recommendations

- Auditors should not assume that the manager understands internal controls and can develop a system that includes segregation.
- Consider the business environment and compensating controls.
- Encourage Human Resources management, such as employee cross-training.

Suggestions for Segregation Reviews

Below is a list of basic steps that can assist in assessing segregation of duties:

- Gain an understanding of the security universe, including the business environment, security settings, and compensating controls.
- Have a brainstorming session for potential fraud risks similar to guidance from Statement on Auditing Standards (SAS) 99.

Review Suggestions (cont.)

Basic steps that can assist in assessing segregation of duties:

- Link fraud risks to duties that should be segregated.
- Develop a library specific to your organization of tasks and access points that should be segregated.
- Use automated tools to create a list of individuals with potential segregation of duties issues.

Examples

- The following are examples of control structures I have encountered in my career.
- The names are changed, but the details remain largely intact.
- After the examples we will review whether the duties were segregated and what contributed to the fraud that we found.

Example #1

The Control Structure

- Judy is the accounts payable clerk for a small department. She has signature authority on a checking account and reconciles the checkbook. Her boss approves requisitions and a separate person receives the merchandise.

Example #1

Were duties segregated?

- No. This clerk wrote checks to herself. It was noticed by a coworker when she was out sick one day. She took a total of approximately \$1,200.

Why were the controls not adequate?

- The approval and receipt of merchandise was segregated from the purchase and the reconciliation, but controls were still not adequate.

Example #2

The Control Structure

- Byron was the accountant. His supervisor approved all transactions, and reconciliations were performed by a separate employee.

Were duties segregated?

- Yes. However, that did not stop Byron from being paid for unearned overtime and paying for personal classes and travel on the department credit card. Cash receipts of approximately \$800 were also missing.

Example #2

Why were the controls not adequate?

- The employees in positions to detect fraud were not performing their jobs. It is important to note that segregation of duties is only a portion of the control structure and cannot be relied on solely in the absence of other necessary controls. In this case the control environment or tone of the organization was not adequate.

Example #3

The Control Structure

- Earle is the lab coordinator. He is responsible for setting up technical equipment in laboratories. He also receives deliveries of new equipment and performs the annual inventory of equipment.

Example #3

Were duties segregated?

- This one is easy—they were not segregated. Earle was convicted of taking 31 pieces of equipment worth \$312,000 during two years. He was sentenced to 57 months in prison, 10 years of probation, and restitution of \$300,000. He forfeited his retirement account to pay for part of the restitution.

Example #3

Why were the controls not adequate?

- Here is a prime example why trust is not a control. Earle had full access to and responsibility for all technical equipment in the building. Segregation of duties was ignored and the organization paid the price.

Conclusion

Thank you for your time. Please feel free to contact me if you have any questions.

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