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As accounts payable professionals know, the practice of segregating duties is a cornerstone of solid internal control. It's based on the thinking that by ensuring no single employee handles more than one process within the procurement, payment and accounting for the purchase of goods or services, the risk of fraud drops. As a result, any attempt to move money or other assets outside the company would require collusion between at least two employees. This makes it more difficult to carry out a fraudulent activity, and more likely that the fraud will be discovered.

Of course, no one program can completely eliminate the risk of fraud or internal theft. However, segregating duties appears to be an effective tool. Consider some results from the 2008 Report to the Nation on Occupational Fraud and Abuse, prepared by the Association of Certified Fraud Examiners. The researchers examined 959 cases of occupational fraud that were investigated between 2006 and 2008.

While the report doesn't specifically look at the impact of segregation of duties, it did compare the amount of loss experienced by firms who had implemented policies of job rotation and mandatory vacation with those that hadn't. Rotating employees between jobs and enforcing mandatory vacations works similarly to segregating duties, to some degree, as both force different individuals to initiate, review and account for transactions. The report found that the median loss experienced at companies that imposed job rotations and mandatory vacations was $64,000. That was less than 40 percent of the median loss of $164,000 experienced by companies that lacked this control measure.

If the increased number of fraudulent activities making the news – from Enron to Bernie Madoff – has any sort of silver lining, it may be that many senior management teams have a greater appreciation for the principles behind segregation of duties, says Sherry DePew, vice president of product management with Lavante. Previously, some companies at least implicitly accepted the increased risk of fraud that resulted from decisions not to segregate duties, if it allowed them to operate more efficiently. "Companies aren't willing to accept that risk any more," DePew says.

Keys to Success

Instead, they want a process in which "creating a payment for someone who shouldn't have one, or changing a bank account, always requires two people," DePew says. In most companies, segregating duties within the accounts payable department means that a different person handles each of the following functions: authorizing purchase orders, receiving goods, issuing payments and recording the transactions. These sometimes are referred to as "incompatible duties," since the goal is to ensure that no one employee handles two of these.

A first step in establishing a program of segregating duties is to work with management to develop a culture that fosters and promotes internal control. Of course, most management teams within accounting and finance have a very good appreciation for the rationale behind segregating duties. Managers in other areas also should have an understanding of the concepts. That way, they'll be less tempted to try to circumvent the processes.

A next step is to analyze employees' job responsibilities, looking for any positions that contain more than one incompatible duty. If some are found, management needs to work with the employees involved-

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to move the responsibilities to employees who won't have conflicts.

This can require some finesse, as employees who lose job responsibilities may wonder if their integrity is being questioned. Joanne Hunsicker, an accounts payable consultant, ran into this when she oversaw an AP department, and had to shift job responsibilities from dedicated, honest employees who had inadvertently assumed responsibility for several incompatible functions. "Sometimes people take it personally and don't understand the bigger picture of avoiding corporate fraud," she says.

To alleviate their concerns, Hunsicker let everyone know that the changes weren't driven by concern over any particular employee's work, but by the need to divide job responsibilities so that the company was protected, no matter who was in the position. Many employees' job responsibilities had evolved over a period of time, and no one may have realized that they had assumed responsibilities that would put them in position to, for instance, both approve vendors and issue checks. Hunsicker also pointed out that removing incompatible duties from an employee's job responsibilities helped protect the employee against baseless allegations.

One way to reduce the likelihood that job responsibilities evolve in such a way that one employee ends up handling several incompatible functions is to provide all managers with a list of these responsibilities. Before they make adjustments to their staff, they can check the list to see where conflicts might arise.

At the same time, it's important to ensure that a program of segregating duties is followed in spirit, and not just technically. After all, it doesn't enhance control if a manager hurriedly signs off on a pile of invoices without reviewing them.

Similarly, employees who are trying to do their part to refrain from taking on conflicting duties should find support within management. For instance, a manager (either within or outside the accounts payable area) shouldn't be able to strong-arm the administrator of the vendor master file into issuing a special check to a vendor. If the check really is needed – say, the vendor completed a rush order before it was even set up in the system – a third employee should be brought in to issue the payment.

It also makes sense to assign an employee who's outside the payment process to review orders to vendors. This helps to ensure that employees are not colluding with someone outside the organization.

Challenges

Even companies that are committed to the principle of segregating duties can find it difficult to practice in real life. Staff reductions have left many departments, including accounts payable, with just a handful of employees. Similarly, a company's branch offices or far-flung plants may have just a few employees in their entire accounting departments. At the same time, the growing use of automated financial systems may lull some managers into thinking that technology itself is enough of a control measure.

If an AP department consists of just one or two people, dividing up each of the functions within the procure-to-pay process becomes more difficult. To compensate for this, the department manager may bring in an employee from another area, such as accounting or operations, to review invoices or sign off on checks, DePew notes. Depending on how large the company is, handling this responsibility may take just an hour or so each week.

As the report on occupational fraud made clear, implementing policies of enforced job rotation and mandatory vacations also helps. These policies ensure that a fresh set of eyes will be reviewing another person's work.

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Another area of concern – and one that's often overlooked – centers around vendor payments that, for whatever reason, are returned to the company, DePew says. These often don't have a designated recipient. To ensure proper control, the person who generates the payments should not be allowed to handle the ones that are returned. If no one else knows they were returned, this employee could alter the payments and deposit them into a dummy account.

Technology

No matter the size of the accounts payable department, technology can aid in enforcing the separation of duties. As a starting point, many ERP systems can be programmed to allow each employee to handle only one part of the procurement and payment processes, DePew says. Many systems apply what's referred to as "the concept of least privilege." In other words, each employee is allowed access only to those applications specifically required to do his or her job. It also means that employees may be able to view just limited pieces of information, such as just the last four digits of employees' purchasing card numbers. Some ERP systems also will periodically check that no employees have inadvertently been assigned more than one incompatible function.

Accounts payable professionals also can work with their IT colleagues to design reports that are relevant, complete and easy to access and read. In this way, technology can compensate, at least to some degree, for the fact that most managers have limited time to review information, such as lists of new vendors added to the system, Hunsicker says.

In fact, many IT professionals can offer ideas that will improve AP processes, Hunsicker adds. Most have some knowledge of accounting and control principles, along with a solid understanding of the systems themselves. As a result, they may notice potential vulnerabilities that an AP professional may overlook.

Finally, most firms will benefit from the insight a post-audit review can provide. "I strongly believe in this," Hunsicker says. Often, these professionals can find areas in need of improvement, as well as loopholes that have been overlooked. For example, at one of Hunsicker's previous employers, the post-audit firm found that when manufacturing returned a product to a vendor, no one was sending the supporting documentation to accounts payable. As a result, it wasn't clear that the company was receiving

Once a post-audit review is complete, the recommendations need to be put into practice. As with many processes, the practice of segregating duties is ongoing, Hunsicker notes. To remain effective, AP professionals need to continually confirm that the theory is being applied in real life.

About Karen Kroll

Since 1994, Karen has been reporting and writing on business, corporate and consumer finance, technology, and workplace trends. Her work has appeared in CFO Magazine, Business Finance, IndustryWeek, TheStreet.com, and Inc. Magazine, as well as a variety of consumer and trade publications. She is a frequent writer and contributor for AP Matters, the magazine produced by IAPP. Check out Karen's latest AP Matters feature, "AP Navigates the Great Recession".

About Lavante

Lavante is helping to educate and promote discussion within the AP profession about the ever-changing and increasingly strategic role of AP within the larger business organization. Throughout the year, we will team up with industry experts to bring you topical and relevant webinars, whitepapers, and articles discussing wide-ranging issues such as: how to turn a recovery audit into a strategic audit for long-term impact; how to manage your vendor file to improve cash flow; and, other procure-to-pay trends and best practices that matter to you, the AP professional. See www.lavante.com for the latest information.

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