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Proper Segregation of Duties Can Lead to Cleaner Audit
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Many of you have recently finalized the annual or, in some cases, periodic process of engaging an outside public accounting firm to audit your organization's financial statements. Along with an audit report, you most likely received a "management letter" or a "letter of management recommendations and comments." It is very common in smaller organizations, particularly in not-for-profits, to also receive, either in a separate communication or within the management letter, a "report on reportable internal control condition noted in audit." A reportable condition is briefly defined as a significant deficiency in the design or operation of the internal control of the organization. An auditor is required to report to the organization's management any reportable condition that is noted during the audit engagement. Commonly, the deficiency in the internal control system causing the reportable condition is a lack of segregation of duties.

An internal control system of an organization is a set of financial, accounting and management procedures designed to safeguard the assets of an organization (cash, investments, artwork, etc.) and to protect the integrity of its financial reporting. A well-designed internal system will reduce, but never eliminate, the chance of financial misrepresentation, fraud and/or asset misappropriation. The foundation of a well-designed internal control system is proper segregation of duties within the organization.

Essentially, proper segregation of duties means that no one individual is solely responsible for controlling a financial or reporting transaction from start to finish. An example of this would be that the person opening the mail should not be responsible for making the deposit of any cash received or for recording the deposit into the accounting system and individual parishioner records.

Another example would be that the individual responsible for the preparation of checks in payment of vendor invoices should not have signature authority and should not have the authority to approve the payment of the invoices. The need for proper segregation of duties extends over most areas of the operation of an organization, such as those involving cash receipts and cash disbursements, the payroll function, the oversight of facilities and equipment, and the investment of surplus funds.

All organizations should strive to have proper segregation of duties in place in these key financial areas. However, there is a cost factor involved in achieving this, since spreading out the various duties means either increasing the duties of existing staff, who may be already overburdened, or hiring additional staff. Either option may be difficult in these days of tight budgets and limited staffing.

There still are many other ways to promote better segregation of duties that do not have a significant human or financial cost. As you look at your own organization's system, keep in mind two simple rules: 1) custody of assets must be segregated from the record-keeping of the assets and 2) authorization of a transaction must be separated from the recording of the transaction into the accounting system. The more people involved, the better the segregation. For further ideas and guidance, you should follow up with your audit firm, members of your board or finance council experienced in this area, or an outside consultant. Properly segregating duties may help you avoid that "reportable condition" part of your audit.

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