

NMSU Audit Services
Internal Control Training Supplement – Segregation of Duties
Spring 2004

Classic Controls:

- Proper Documentation of Transactions – without this, controls cannot be verified.
- Proper Authorization of Transactions – part of limiting access to assets.

Compensating Controls:

- Unique controls that replace classic controls - considered during management's cost-benefit analysis.
- Proper design of compensating controls = similar benefit of classic controls.

Ideally, duties should be segregated so that different people are responsible for:

- Authorizing transactions (classic control – part of limiting access to assets)
- Recording transactions (recordkeeping/accounting – safeguarding assets by limiting ability to add, change and delete records)
- Maintaining custody of assets (safeguarding assets by limiting physical access to them)
- Monitoring (performing reconciliations – verifying data in reports or existence of assets by independent third party report; independent checks by someone who does not have physical custody of assets; management review of financial reports for propriety and trends)

When one individual performs all of the duties listed, they have control over transactions from beginning to end. This puts them in a position to create and conceal errors and irregularities that might go undetected. Furthermore, an employee may be placed under undue suspicion if irregularities are discovered, particularly if other individuals have physical access to assets. Internal controls protect assets, which include employees and the reputation of the institution.

Compensating Controls – must be used when proper separation of duties is impractical (i.e., small department). Examples:

- The same person who performs recordkeeping also has custody/physical access to assets – monitoring by a different individual must be “beefed up”.
- The same person who has custody of assets and is performing reconciliations – that person must not have recordkeeping duties and additional monitoring recommended.
- The same person is performing recordkeeping and monitoring – that person must not have custody of assets.
- The person with custody of assets should not be the same individual who is performing key monitoring controls.

There must be a “break” in the process!

Note: College and division business managers, along with Business & Finance personnel, can perform a great service by helping with monitoring duties. However, they cannot take the place of unit management who should always be in the best position to know whether or not a particular transaction is appropriate (authorizations and approvals). Controls are defeated if management delegates monitoring responsibilities to the same individuals responsible for the other activities listed.