

Segregation Of Duties In Accounts Payable



Why Segregation of Duties is Important in Accounts Payable

Segregation of duties is important in both accounts receivable and accounts payable. Also known as separation of duties, using these internal controls helps to mitigate potential errors, reduce the occurrence of fraud, and ensure accuracy. It's never a good idea to have one person in charge of any accounting process, and accounts payable is no exception.

Managing accounts payable properly is important for numerous reasons. Processing invoices promptly, and paying them when due helps companies build a strong relationship with vendors. On the other hand, late or inaccurate payments can quickly destroy a vendor/business relationship.

Another reason why managing accounts payable properly is so important is because of the potential for payment fraud. It's well known that accounts payable is particularly prone to fraud if proper guidelines are not followed.

That's why segregation of duties is vital for any business. Whether you have a

small business or a global organization, segregation of duties is a necessity.

What does segregation of duties mean?

Segregation of duties is an internal control process that all businesses should implement if possible. While the one-person office is likely the sole processor of all accounting transactions, even a two-person office should implement some form of segregation of duties.

Used to reduce errors and mitigate fraudulent activity, segregation of duties simply means that more than one person should be involved in a particular process.

For example, in accounts payable, it's recommended that one person be responsible for setting up vendors in the system, with one person responsible for entering invoices and running checks, with a third person responsible for signing those checks.

What are internal controls in accounts payable?

Accounts payable controls are put in place to safeguard the process from errors or fraud. These controls can help to mitigate a variety of risks, including payment errors, duplicate payments, late payments, and even fraudulent payments. These controls are usually broken down into three categories.

1. The obligation to pay

When you receive an invoice from a vendor, that creates an obligation to pay; provided that the following are verified:

- Purchase order verification - A purchase order is typically used when purchasing products or services from a vendor. The purchase order should always be reviewed for accuracy before issuing a final order approval. The vendor should also be verified for legitimacy.
- Invoice approval - The next step is verifying the invoice. This includes verification that the products or services were received as indicated in the

purchase order and that the amount of the invoice is accurate.

- Document matching - The next step completed is the three-way match to ensure that the purchase order, invoice, and the receipt of goods reporting all match.
- Look for duplicate payment - Prior to entering an invoice for payment, you should always verify that duplicate invoice numbers do not exist. Taking this extra step will eliminate costly duplicate payments.

2. Data entry

Once the invoice has been verified, you're ready to move on to the data entry stage. Unfortunately, this is the stage where most of the potential errors are made. Depending on your internal accounts payable process, you can choose to enter an invoice into your accounting system immediately, and then obtain approval, or enter the invoice after it's been approved.

A helpful process can be adding up the total of your invoices and then reviewing accounts payable financial reporting totals to verify that they're in balance.

3. Invoice payment

Whatever your internal payment process, invoice payment is an area where segregating duties is essential. For instance, one person can run checks, and another person can review and sign the checks. No single person should have the authority to run, review, and sign checks.

Potential issues can be reduced or eliminated by using procure-to-pay software, which we'll talk about later in this article.

Having segregation of duties in place can reduce or even eliminate fraud. If you have one employee vetting vendors, entering invoices, paying those invoices, and writing checks, there's no safeguard in place to prevent that employee from creating a fictitious vendor and writing a fraudulent check.

Which duties should be segregated?

The accounts payable process is the management and payment of the company's

short-term debt. While the accounts payable process often mistakenly starts with entering a vendor invoice, the accounts payable process starts much earlier, when a product or service is purchased.

- While smaller businesses often skip the purchase order process, mid-sized to larger businesses typically have a purchasing department in charge of locating and vetting vendors and placing orders. Larger businesses may also have a receiving department that verifies that the order received matches the original purchase order.
- Once this process is complete, an invoice is received by the AP department, where it then becomes the job of accounts payable to verify all of the information on the invoice, such as the number of products ordered, verifying that the information on the invoice matches the purchase order as well as the receiving report, if available.
- Next, the invoice information is entered into your software application for the amount indicated on the invoice, with the due date specified.
- When the due date is close, a check or electronic payment is processed.

All of these duties should be segregated. In other words, the person purchasing the products or services should not be the same person that enters the invoice, nor the person who signs the checks. At minimum, the following duties should be assigned to at least three employees.

- Purchasing products- In larger businesses with a purchasing department, this is standard practice, but for smaller companies with fewer employees, purchasing and approvals should always be separate.
- Confirmation of receipt of products - The employee who places the order should not be the same employee who confirms receipt of the order.
- Reviewing an invoice - Reviewing and approving an invoice should be completed before the invoice is entered into the system to be paid. This process also includes vetting vendors if not done by the purchasing department.
- Entering an invoice - entering an invoice can be done by a clerk, provided that they have not initiated the purchase in any way.
- Paying an invoice - Paying an invoice either electronically via ACH or by check should be completed by a separate employee.
- Signing the checks - If you still process checks for your vendors, the check run should be completed by one employee, with another employee

signing the checks.

An example of segregation of duties

Jim runs a small business, with five staff members, including two clerks in the accounting department, with Jim approving all new vendors. When he receives an invoice, he verifies that the goods have been delivered as indicated on the invoice, or the services received. He approves the invoice and routes it to his accounting clerk, who entered it into their accounting software application.

The second accounting clerk reviews the accounts payable report against the invoices, spotting and correcting any errors. When it's time to pay the vendors, the second clerk is told which invoices should be paid. Once checks are processed, or electronic payments prepared, Jim approves the payments and signs the checks.

While this is a simplified version of segregation of duties, the main takeaway is that the person who initiates payment or completes the check run should not be the same person who approves electronic payment or signs the checks.

What are the benefits of segregating duties?

Spreading accounts payable tasks between multiple employees offers multiple benefits. It helps to reduce error occurrence since more than one person is involved in the process from beginning to end. Having a second set of eyes can help catch errors quicker than relying on one person to review, enter, and check all accounts payable transactions.

But even more important, from an audit standpoint, having segregation of duties in place can reduce or even eliminate fraud. For example, if you have one employee vetting vendors, entering invoices, paying those invoices, and writing checks, there's no safeguard in place to prevent that same employee from creating a fictitious vendor and writing a fraudulent check.

What are the disadvantages of segregation of duties?

For smaller businesses, the need to add an additional employee to truly segregate duties may be the only disadvantage. In the end, choosing not to segregate duties puts your business at high risk for errors and fraudulent activity.

What is the difference between segregation of duties and a sign-off?

A sign-off is used more often in smaller businesses, where complete segregation of duties may not be possible. For example, Sara is the only accounting clerk for a small business. Linda, the owner of the business approves vendors and invoices, then gives them to Sara to enter. When invoices are due, Sara runs a report, which Linda signs off on to determine which bills should be paid. After entering payment information electronically or after running checks, Linda then approves the electronic payments, or signs the checks that Sara has run.

What is the relationship between the segregation of duties and the principle of least privilege?

Though similar in scope, there are some differences between segregation of duties and the principle of least privilege. The principle of least privilege states that computer users should be provided with the least amount of access to perform their job duties. On a related note, segregation of duties indicates that employees should not be authorized to complete an accounting function on their own. Using the segregation of duties principle when setting up access to your accounting or procurement software application will provide staff members with the ability to perform the tasks related to their job and nothing more.

How does procure-to-pay software help with internal controls?

Purchasing is a big part of the accounts payable process, which is why utilizing a procure-to-pay application such as PLANERGY can be helpful. Procure-to-pay software offers complete automation of the entire purchasing and accounts payable process, from initial order to vendor payment, all while enforcing internal controls. Using procure-to-pay software, you can manage your vendors, create workflow solutions, view purchasing activities at any time, and automate the invoice approval process. You can also process accounts payable disbursements while reducing errors and eliminating the possibility of fraud.

Whether you're using a small business accounting application or an ERP system, you can benefit from using procure-to-pay software.

Segregation of duties is part of the accounting process

The appropriate segregation of duties should be part of your internal controls. While challenging for smaller businesses, more than one person should always handle the following if possible:

- **Initiating a transaction** - this includes creating an initial requisition or purchasing an item or service.
- **Approving a transaction** - if you initiated the transaction, another employee should approve it for payment.
- **Entering or recording transactions** - this includes recording the transaction or setting it up for payment.
- **Processing a payment transaction** - this includes preparing an invoice for payment or completing a check run.
- **Approving payment or signing a check** - an employee that prepares electronic payments or other expenditures should not approve payments or sign checks. This includes any petty cash transactions.
- **Handling the bank reconciliation** - anyone entering or recording a transaction, or approving a transaction should not be a signer on the bank account or handle the bank reconciliation process.

These preventative measures will reduce errors, ensure payments are made accurately and on time, and help to eliminate fraud. If you're not segregating duties in your business, you should implement the process today.

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