Office of Risk and Internal Controls Services

Control Awareness Bulletin (CAB) – February 17, 2012.
The Use of Compensating Controls

Introduction

An important factor that a manager considers when designing a business or financial process is the identification of incompatible functions and the appropriate segregation of such functions by assigning them to different personnel. Segregation of duties is an important internal control element because it promotes the use of sound business practices and supports the achievement of a process objective. However, effective segregation of duties might not be achieved in certain situations, such as an employee performing all activities within a process, one person having incompatible access in a financial application or a small department having few employees. When adequate segregation of duties does not exist and cannot be addressed in a timely manner, a manager's next alternative is to consider implementing compensating controls. A compensating control reduces the vulnerabilities in ineffectively segregated functions, which include the risk of errors, omissions, irregularities and deficiencies in process quality.

Examples of Compensating Controls

If the above description reflects the current situation in your department or an activity within your area of responsibility, then you may consider implementing any of, or a combination of, the compensating controls described below:

a. Skim through detailed transactions report: A manager may consider performing a high level review of detailed report of transactions completed by an employee that performs incompatible duties. Follow-up questions should be asked if any transaction is flagged by the manager. In situations where the detailed transactions report is voluminous, managers may consider prioritizing the types of transactions or accounts to be reviewed. For example, a manager may simply skim through the report sections that contain high risk transactions or accounts.

b. Review sample of transactions: On a periodic basis, a manager may select a few sample of transactions, request for the supporting documents and review the documents to ensure that they are complete, appropriate, and accurately processed. In addition to detecting errors, the periodic reviews could create a disincentive (that is, reduce the opportunity) for the person performing the incompatible duties to process unauthorized or fraudulent transactions.

c. Review system reports: Most applications that support business or office operations have embedded reporting capabilities that enable the generation of reports based on pre-determined or user defined criteria. A review of relevant system exception reports can provide good compensating controls for an environment that lacks adequate segregation of duties. For example, review of report of deleted or duplicated transactions, report of changes to data sets and report of transactions exceeding a specific dollar amount.

d. Perform analytical reviews: Another example of compensating control is the comparison of different records with predictable relationships and the analysis of identified unusual trends. For example, a budget vs. actual expenditure comparison or current year vs. prior year subscription fees analysis or comparison of selected asset records to actual physical count of asset might indicate unusual variances or discrepancies that may need to be investigated.

e. Reassign reconciliation: If there is an opportunity to reassign one activity from the person performing incompatible function to another employee, a manager may consider re-assigning the reconciliation activity. For example, reassigning the bank account reconciliation function to someone other than the person receiving cash and depositing it to the bank could improve the quality of internal controls in the cash receipt process.

f. Increase supervisory oversight: Other forms of activities a manager may perform as compensating control are observation and inquiry. Where appropriate, increasing supervisory reviews through the observation of processes performed in certain functions and making inquiries of employees are good administrative controls that may help to identify and address areas of concerns.

Conclusion

Effective compensating controls can improve the design of a process that has inadequate segregations of duties and ultimately provide reasonable assurance to managers that the anticipated objective(s) of a process or a department will be achieved. We hope the above information is helpful in assisting you to identify the need for and the types of compensating controls that may be relevant to your environment. Please email or call us if you have any questions and/or comments regarding this bulletin or the services provided by the Office of Risk and Internal Controls Services.

Thank you for your time and attention.

Regards,

Adewale Soremekun
Internal Controls Services

Kate Lark
Director, Office of Risk and Internal Controls Services