SafePaaS™

Control Financial Misstatement Risk

with effective segregation of duties

Just thinking about inaccuracies in financial reporting is enough to make any finance manager sweat. And for a good reason. Inaccurate financial reporting can have harsh consequences. Financial statements contain essential information about your company's soundness to leaders, stakeholders, and investors who depend on their accuracy when making critical management and investment decisions.

Ideally, financial reporting would be error-free. But to err is human, and unfortunately, inaccurate reporting can occur. SoD (Segregation of Duties) is your best line of defense in ERP security and financial statement accuracy.

How can your enterprise protect itself from the risk of too much responsibility residing with one person? This ebook will discuss the Segregation of Duties (SoD) and its critical role in enabling businesses to minimize the risk of financial misstatement.

What is financial reporting?

Financial reporting is the documentation and communication of economic activities and performance to internal leaders and external stakeholders. Financial reporting provides a clear picture of your company's financial health over a specified period–typically quarterly or yearly. It also lets government and private regulatory institutions monitor the business to ensure fair trade, compensation, and financial activities.

In the United States, only private companies with over **$10 million** in assets and more than **500 shareholders** are required to file financial reports with the SEC. However, most businesses create them to organize accounting data and understand the company's financial health. Financial reporting is also used to receive funding from banks, investors, or other sources.

Financial reporting typically includes:

- **The balance sheet -** provides a snapshot of the business's overall health—or what it owns, what it owes, and shareholder equity.
- **The income statement** (also called the profit and loss statement) - breaks down the company's revenue, its cost of revenue, operating and non-operating expenses, and non-operating income.
- **The cash flow statement -** indicates how much cash came into a company during a reporting period and how much money was spent.

Some businesses may also put out an annual report that includes financial statements and more detailed information about yearly performance, including critical business goals, achievements, and information on leadership. Financial reporting helps leaders monitor income and expenses and ensures the business complies with mandatory accounting regulations. It also supports deeper financial analysis, tracks past performance, identifies critical spending areas, and provides data needed to make better budgeting and forecasting decisions.

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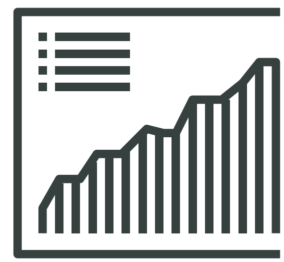
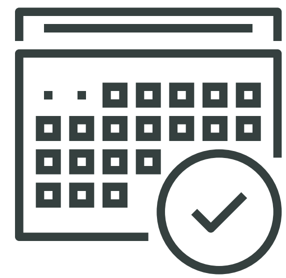
The importance of financial report accuracy

They say "that numbers don't lie," and that is truer in financial reporting than anywhere else. The numbers revealed through these financial statements play an enormous role in decisions making, strategic planning, evaluating success, estimating losses, and communicating the health of your company to leadership and the market. Accurate financial reporting is essential for stakeholders, management, and creditors because they rely on the information to make decisions about investments, strategic plans, and creditworthiness. If your financial reporting is inaccurate, it can lead to legal concerns, falling stock prices, and poor company outcomes.

While the accuracy of financial reporting is important, **timeliness** is just as critical. Data that is not available when needed can result in lost opportunities for the business and even result in fines if financial statements do not meet the deadlines defined by regulatory agencies.





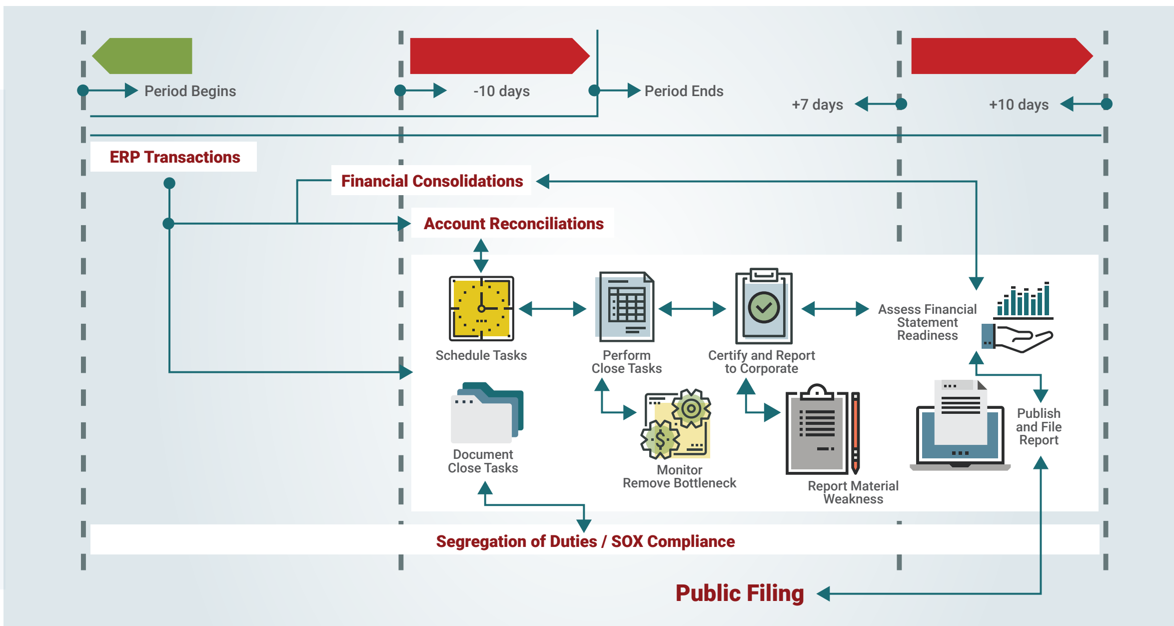
Preventing inaccurate financial reporting

The most effective way to avoid financial reporting errors is to prevent them with robust controls. Controls are policies, procedures, and technical precautions that safeguard an organization's resources by avoiding mistakes and inappropriate actions. Controls, such as the segregation of duties, access controls, automated process controls, and internal audits, can help prevent errors and increase the ability to detect mistakes and **fraud**.

Effects of inaccurate financial reporting

The impact of financial reporting inaccuracies can be wide-ranging and even devastating to the company, its stakeholders, and investors. Among those consequences are:

- **Fines and penalties -** Inaccurate or late reporting can lead to penalties and fines levied by the UK stock market regulators such as the SEC in the US and the FCA in the UK.
- **Reputational damage -** Errors in financial reporting compromise the company's credibility.
- **Lost time and resources -** You may spend hours or days each quarter reconciling financial data. That can turn into salary dollars spent correcting errors and fighting fires.
- **Difficulty planning -** Companies rely on financial data to budget, forecast, and develop performance indicators. Overreporting cash flow can cause a company to be short on funds when paying bills or payroll. Similarly, underreporting cash flow can mean missing investment and income opportunities.
- **Bad decisions -** Inaccurate information can lead to poor operational choices such as pricing, hiring, and layoff decisions.



Segregation of Duties best practices for accurate financial reporting

The primary methods used to ensure the accuracy of financial reporting are internal controls and external audits. **Internal Control over Financial Reporting** (ICFR) continues to be an intense focus of regulators, and ICFR has been required of public companies for over a decade. Often the conversation around ICFR is based on regulatory expectations. Still, an equally important discussion focuses on the intent of those regulations, which is to increase trust in financial reporting by establishing reliable systems and controls. As a result of SoX, large public companies are required to perform an external audit, which includes an efficacy assessment of the company's ICFR and an internal evaluation of control efficacy.

Controls

The rules and processes put in place to mitigate various risks that can arise within the organization. **Controls** must also align with regulations and standards, such as SOX or **Directive 2014/56/EU**, established by regulatory bodies. One control of particular importance to the accuracy of financial reporting and avoiding a material misstatement are Segregation of Duties controls.

SoD is a control created to prevent fraud and error in financial transactions. SoD ensures that at least two individuals are responsible for completing a critical task that has economic consequences or can impact financial reporting. SoD breaks down processes into multiple tasks to ensure that ultimate control over a process is never in the hands of one individual. SoD accomplishes this by splitting a transaction or other non-financial process into two or more steps or requiring approval from another party before completion.

For example, payroll and purchasing are fraught with error and fraud risks. Commonly, one employee is responsible for setting up the payment, and another employee is responsible for signing checks. This way, there is no workaround where someone could pay themselves or make purchases for a coworker.

An example of the segregation of duties in a non-financial capacity with an equally damaging impact on financial reporting and fraud is user access requests. User access requests should be requested, reviewed, and granted by different process stakeholders to ensure that the user is only granted access to data and applications that are essential to complete their job and nothing more. If a user is granted access above what is necessary, they could potentially access and change financial data, putting the company at risk of a **material misstatement**.

External audits

You may be surprised to learn that external audits are not the best way to rectify financial reporting inaccuracies. External audits are a regulatory requirement and a best practice, but they do not guarantee the accuracy of your financial statements. The objective of an external audit is to identify risks, provide independently verified information, determine the completeness of the accounting records, and ensure that the documents are prepared according to the applicable accounting framework to present the company's financial position with actual and fair results.

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5 WAYS SafePaaS mitigates financial misstatement risk caused by inadequate Segregation of Duties

SafePaaS provides a robust ERP controls platform for the automated detection, mitigation, remediation, and prevention of access risk and segregation of duties to mitigate financial misstatement errors. Implementing effective automated segregation of duties is critical to efficiently managing and mitigating material misstatement risk.

To effectively manage SoD risks from a governance perspective, the platform you use must have the capability to:

1

Detect segregation of duties risks

An SoD violation occurs when a user exploits an SoD risk by performing both ends of a separate business process to complete one or more transactions. Technically, a violation occurs when users gain access to a point above their assigned level within the workflow. As in the case at Yale, the ability to enter vendor invoices and approve payment is an SoD violation. However, without comprehensive SoD policies and advanced analytics, detecting violations across thousands of applications can be extremely difficult to accomplish.

Your SoD solution should leverage a custom rule set and identify SoD and sensitive access conflicts. Performing this analysis will allow the enterprise to gain visibility into the current state of SoD-related access risks within the ERP system and remediate those risks. SafePaaS has easy-to-read, intuitive, drill-down, real-time dashboards. The dashboard has several different reports to choose from to devise your remediation strategy.

2

Remediate segregation of duties risks

Remediation is crucial in addressing access control incidents where policies have determined the existence of a violation. Remediation involves multiple participants from the business, audit, and IT to determine the appropriate corrective action.

The following are considerations for remediation:

- Access risk remediation requires two significant types of corrective actions.
  - When a user has access to conflicting entitlements that pose "inherent risk," the security configuration in the application requires updating.
  - Reassigning user roles where the violation is caused by the user having access to two or more conflicting roles.
- Role security configuration is the root cause for most access policy violations, but updating roles in an ERP system with hundreds or thousands of active users can negatively affect business performance. However, with Enterprise Roles Manager, new roles can be safely simulated to test for SoD conflicts before being deployed into production, eliminating the risk of adverse performance impacts.
- Companies and auditors get bogged down during remediation because of the difficulty in changing the security design to allow business users to perform their tasks.
- We recommend automating the role redesign process by analyzing source roles with violations and creating "target" roles that can be reconfigured and tested for access policy compliance before deploying the compliant roles into the production system.

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Prevent segregation of duties risks

As previously mentioned, Segregation of Duties is a control used to prevent fraud, theft, misuse of information, and other security breaches. This is accomplished by dividing a process into separate tasks so no one user has control over an entire process. SoD is the most effective way to place controls over your organization's assets and prevent financial misstatements and fraud. SoD serves a two-fold purpose:

- It ensures that you have oversight and review of access and control of conflicts within your organization.
- It helps you prevent fraud or theft because it requires two people to conspire to hide transactions and errors.

SoD controls provide a layer of checks and balances on the activities of your users and help you keep track of access violations.

Lookback analysis

Auditors may require a look-back analysis to review prior-period evidence of potential risk and to evaluate the effectiveness of the access controls management process. This is done by detecting incidents where the risk detected during the audit analysis may have materialized.

For example, the SoD controls analysis identifies the users who violate one or more SOD policies. Once the violations are detected, and most of the risk is remediated or mitigated by fixing security roles or changing user access assignments, the remaining unmitigated "residual" risk requires lookback analysis. Residual risks exist in most complex ERP systems because the remediation process is labor-intensive and requires process changes or additional staff. All of these options are time-consuming and expensive.

Residual risk requires auditors to perform a look-back analysis to detect users that performed conflicting activities where the risk was not mitigated. For example, if users in the payables department had the ability to Create a Supplier and Pay a Supplier, how many of those users performed such transactions during the audit period? This analysis qualifies SoD risks by identifying and quantifying the financial exposure from SoD violation transactions, e.g., creating a supplier and paying that supplier. This type of analysis, historically a monumental task, can be automated with SafePaaS Advanced Analytics.

Transaction monitoring

Transaction Monitoring improves your visibility into financial, operational, fraud, and risk management controls. It allows management to track the flow of transactions across IT infrastructure and detect, alert, and correct unexpected changes in business or technical conditions. Transaction monitoring provides visibility into the flow of transactions across the IT infrastructure and can monitor risk across all major business processes, including Financial Close, Order-to-Cash, Procure-to-Pay, Treasury and Cash Management, Human Capital Management, and Product Life Cycle Management. Transaction monitoring allows businesses to investigate transaction errors within their ERP that do not comply with SoD, governance policies, regulatory requirements, or business performance objectives.

Unfortunately, errors and fraud are a reality that businesses increasingly contend with. Unintentional errors and fraud can lead to material misstatements resulting in lost time and money and, in the worst cases, reputational damage and bankruptcy. The risks to the company are substantial, but understanding the causes of inaccuracies and implementing robust controls can have a powerful impact on preventing errors and fraud and mitigating the risk of financial misstatement.

For more information on how SafePaaS can mitigate financial misstatement risk, **READ MORE**

SafePaaS
3300, Dallas Parkway, Suite 200
Plano, Texas, 75093 USA

CONTACT US

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