FOUR EYES

SEGREGATION OF DUTIES IS CRITICAL TO PREVENTING FRAUD AND ERRORS, WRITES SARAH BOYCE

Treasuries deal with large sums of money on a daily basis and two of the key operational risks are fraud and error. In our article last month (see *The Treasurer*, April 2015, page 49), we started to discuss the importance of strong controls within treasury. In particular, we focused on fund flows and the benefits of using standard settlement instructions (SSIs). In this article, we will consider another aspect of treasury control: the separation of roles, known as segregation of duties.

Segregation of duties is the notion that no employee should be in a position both to **commit** and to **conceal** fraud or errors – whether deliberately or accidentally – in the usual course of their duties. This is sometimes referred to as the 'duality' or 'four eyes' principle.

When considering how to prevent error or fraud, the principle is to involve several people and/or technology throughout the life cycle of a transaction in order to minimise the risk of fraud or undetected errors slipping though.

In treasury, traditionally, roles are separated between the front office, the middle office (predominantly in large organisations) and the back office.

Front office

The front office is responsible for:
- Working with the business to identify exposures;
- Providing market information and pricing advice to the organisation;
- Cash management;
- Dealing (money markets, FX, interest rates, long-term funding); and
- Deal entry into the treasury management system (TMS).

Middle office

Typical middle office functions include:
- Ensuring that deals are transacted in accordance with authorisation rules;
- Monitoring limits and reporting limit breaches;
- Analysis and reporting of exposures;
- Performance reporting and use of counterparties;
- Maintaining bank account and dealing mandates; and

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- Processing and reconciling changes in standing data, such as SSIs.

Back office

The back office administers and supports the front office; its main functions are to:
- Confirm treasury transactions in a timely manner;
- Settle deals when due;
- Perform bank reconciliations in order to ensure all funds have moved as expected;
- Account for transactions;
- Provide all necessary reporting where no middle office exists; and
- Supervise the functionality and controls established within the TMS.

The front-office and back-office roles should be performed by different people who have different reporting lines. This means that in smaller companies finance staff, and sometimes key operational staff, will perform some front- or back-office tasks. This is perfectly acceptable, as long as they understand their role.

In a large, complex, international business, however, treasury is likely to involve a number of staff, who might be either professional managers, such as a regional treasurer, or specialists in particular treasury activities, such as FX dealers or investment managers.

IT can be used as an additional control mechanism, for example, by automatically confirming transactions with the third party almost instantly after execution. Most TMSs can be set up to control access rights and authority levels either by role or by individual.

Here is an example of using separation of roles and technology to minimise risk:
- A front-office dealer transacts an FX deal with a bank and inputs it into a TMS.
- The TMS automatically checks whether this transaction breeches any pre-established limits (ie it confirms whether the dealer has acted within their authority and whether this transaction will result in 'overexposure' to any one counterparty). In an ideal world, these checks would be done before a transaction is executed, but this may not be practical.
- The transaction is automatically confirmed by using third-party software that matches the deal entered by the dealer with the deal entered by the bank, and sends confirmation of the match back to both parties.
- When funds need to be paid over to the bank, a back-office manager will approve the payments that have been generated by the system. A back-office administrator will release the payment to a predetermined bank account. Although both of these steps reside in the back office, they are generally done by different individuals.

Segregation of duties is a key management control designed to reduce the risk of fraud and provide a checking mechanism for treasury.

It is this second role that, in most organisations, is more important, because the nature and complexity of treasury activities means it is likely that, at some point, somebody will make a mistake. Effective controls will enable these to be picked up promptly, enabling rapid rectification, and minimising risk and cost.

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