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Procurement Audits

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October 23 , 2014



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Procurement rules, US Experience

- The Michigan Public Service Commission does not tell the utilities how to manage their companies and that includes telling them how to spend their money.
- HOWEVER The Commission certainly and surely can disallow any excessive or imprudent spending by not allowing recover in customer rates.
- Management is typically responsible for creating internal controls that protect the integrity of their assets which included all their accounting systems.



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Procurement function

- All organizational structures should delegate to separate departments of the company the exclusive authority to make all purchases of materials, supplies services and equipment. (not outside professional services like lawyers and CPA's, these are by reputation or based on other criteria.) The purchasing, receiving, and the recording functions should be clearly separated and lodged in separate departments.
- This type of departmentalized operations may not be possible in small utilities.



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Procurement audit

- The procurement audit scope can be expanded to review the policies and procedures for amounts spent and the support of those amounts that should be controlled designated and controlled by top management.
- It is not the purchasing department that sets the amount of spending for a utility.



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Procurement audit

- Management sets policies and procedures
- All policies and procedures are well documented
- Management determines operating budgets.
 - Auditor reviews budget procedures
 - Auditor reviews past budgets and compares to current.
 - Looking at the background of management for procurements.
 - Internal controls and Internal audits are important to auditor.



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Procurement audit

- Is this audit scheduled annually? Will it annual?
- Is there past audit experience to review?
- Is this audit to support a tariff application?
- Are we looking for assurance that the utility has control over its spending?
- Was there some comment in the Independent auditors report and opinion that would notice the regulator to conduct an audit? Scope of the audit should fit the reason for the audit.



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Procurement audit

- Numbered formal purchase orders should be prepared for all purchases, and copies forwarded to the accounting and receiving departments.
- Copies sent to receiving should have the quantities ordered, with unit price, blacked out to assure that receiving personnel make independent counts of items received.
- Purchase orders are issued only after compliance with extensive procedure and are followed for the need, competitive bids, approvals.



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Procurement function

- All items, goods, equipment should be cleared through a receiving department which is independent of the purchasing department. Separate also is the storing, and shipping-out departments.
- Receiving determines quantity received, quality received, detect damage or defects, prepare a receiving report, transmittal of items to stores department, construction site, or final destination that requesting items. Notification to accounting department. Purchase order is complete? Yes or No



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Planning

First the reason.

- Has there been indication that there is some serious problems with the Utilities procurement program?
- Has the Commission made a formal motion to have the Utility show that they are providing guidelines for their employees by written policies and procedures?
- Has there been a comment about miss-use or assets or fraud? Whistle blowing from utility employees?
- Has the Commission requested an audit without formal order?



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Planning-preliminary work

- Audit Manager reviews Commission request or assigns a formal Commission order to audit Staff Senior.
- If Regulatory Commission does not have experienced audit Staff they will need to contract out or hire a temporary Staff. Hire out ok, but still should have supervision done by knowledgeable Staff person.
- Outside contractors (independent CPA's) will be experienced in compliance, management and single issue audits but do they know the regulatory side?



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Planning-preliminary work

- Auditor begins to compile information such as:
 - Annual report prepared by the Utility for the Commission.
 - Review any other documents including rate case papers.
 - Review files and previous audit reports from Commission archives.
 - Prepare to discuss with Utility the purpose of the audit
 - At conference with Utility discuss Company employees to be used and their role in providing work papers, documents, reports and tour of any Utility facility that relates to subject under review.
 - Prepare to be familiar with Company's physical facilities.



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Planning-preliminary

- Auditor makes first audit request before meeting with Utility or at the time of the initial conference. If a list is given to Utility before initial meeting there is a good possibility information will be readily available upon first meeting.
 - Trail balances of Balance sheet accounts and income accounts
 - Managements Policies and Procedures manual
 - List of all purchase orders for year or two.
 - List of all work orders.
 - Organization chart especially for the purchasing department
 - Utilities Policies and Procedure manual



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Planning

- Request list of approved vendors. Any contracts? Policies for vendors? What method were used to select vendors?
- Request work order activities, involving active lists related to purchases, work orders and purchase order for each month of the year (12 reports/lists).
- Prepare a spread sheet and tie to monthly balances.
- Analysis 12 month spread sheet to determine further sampling. Look for variances or abnormal levels of spending.
- Prepare a questionnaire for various departments relating to the area of procurement. Internal auditors, stores and inventory department, and what about field locations in service territory?



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Planning

- Objectives
 - Determine if Company's compliance with specific management policies and procedures for maintaining accounts, subsidiary records and reporting information for management and the Commission are being followed.
 - Evaluate whether policies, procedures, methods and controls underlying procurements and related accounting are just and reasonable charges to operations.
 - Is there a segregation of responsibilities?



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Planning

- Objectives continued
 - Determine if the Company's internal controls over purchasing and purchase orders, work orders and payment of those purchases are adequate. Need a good auditors questionnaire.
 - Determine that monies spent are reasonable, have been authorized by responsible designated employee. That monies spent are adequately supported by third party documentation.
 - Be assured that books and records reflect the correct amounts for assets and expenses and employees are following management directions.



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Planning

- During review the auditor can also review managements budget procedures. The auditor can follow the methods to arrive at a budget and also determine if those management budgets are reasonable or company “wish lists” out of control.
- If this is a first time procedural audit the auditor could review past history on this issue. That is: go back a couple years and compare if changes have been made and what those reasons might have been to promote change (Independent auditors/internal auditors recommendations).



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Plan of Organization

- Department Autonomy
 - Accounting Department
 - Treasurer/Accounts Payable Department
 - Functions other than accounting and payables
- System of authorization and accountability
 - Execution of Transactions
 - Authorization for purchases
 - Authorization of receipt and storage



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Plan of organization

- Recording of Transactions
 - Matching of supportive documents
- Comparison of Recorded Accountability with Assets
 - Periodic inventory
- Access to Assets
 - Access to inventory
 - Accounting for renumbered documents
 - Reviewed by someone independent of Purchasing and receiving
 - Consistency of data/from one location to another



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Audit of General records

Nonfinancial records

- Contracts with customers and suppliers

Financial records

Financial statements and annual reports of prior years

Any reports that might be filed with other governmental agencies (taxing authority).

Accounting Records

General ledger and any subsidiary ledgers

General journal (the common journal entries listed by month). Any odd or unusual entries or adjusting entries?



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Follow the flow from request to approval to initiate purchase, to receiving that sends invoices on to payable department and notifying accounting to prepare journal entries to recognize the transaction has been completed.

Just because something has been bought and paid for does not necessarily result in the item being recorded properly, protected and safe. When materials, supplies and equipment have been sent off from receiving they still requires security controls until it reaches it final resting place. And then controls continue, Right? Cost?



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- If there are several auditors assigned to the procurement audit, the lead or manager will assign parts of the audit to individuals.
- Best if there is a team of auditors to keep communication open and promote discussion. A way to find an area not readily listed in audit plan. The more the merrier and the synergistic value offers much to the audit.



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Utility management responsibility

- Can't stress this enough. It is management's responsibility to provide everything that is requested by the audit.
- It is management's responsibility to provide support to the auditors for such things as schedules requested, field guidance or physical inspections and plant reviews.
- It is the management's responsibility to respond with what is being requested and to respond in a reasonable amount of time all questions posed by Auditors.



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Management responsibilities/Auditors too!

- While auditors are on utility property they should expect respect and consideration. That also goes both ways.
- It is the auditors responsibility to treat management property, books and records with upmost care. Also treat management and utility employees with respect.
- “Can get more flies with honey than you can with vinegar”. The Utility employees and the auditors are just doing their job as prescribed by their employers.



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Auditor requirements

- Policies for purchasing anything.
- Procedure manual covering purchasing, receiving, safety controls and movement of anything purchased.
- Journal entries for purchases (there are procedures for journal entries too!)
- Activity samples by month.
- Spread sheets for monthly activities
- Spread sheet of several years activities
- Vendor information, bidding contracts/analysis done
- Internal control reports on procurement system.



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Auditor requirements

- Auditors will have to speak with management and possibly internal auditors. Initial step!
- Flow charts of directions taken from request to purchase, approvals, purchase orders, and work orders list for year need to be obtained.
- Large sample taken of purchase orders. Auditor uses sample to determine if any deficiencies exist and if the employees are following procedures as directed so that possible abuse does not occur.



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Auditor requirements

- If any deficiencies have been noted by internal auditors, consider whether appropriate action has been taken by management and whether a need for additional work by Staff auditor is indicated.
- If more work is needed in this area a larger sample will need to be taken. If audit covers 12 months of the year ended, might need to expand sample size for current year activity to be assured that measures have been taken and are working to protect assets/purchasing system.



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Audit

- Arrange for entry conference with agency officials to discuss upcoming audit. Can be via email or 'phone call.
- Submit questionnaire or list of topic to discuss at entry conference.
- Will entry conference be at the Commission offices or will Commission Staff go to offices of the Utility?
- Determine where the majority of the audit work will be performed (desk audit/ company location/ field?)



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Audit

- May provide Utility with audit request #1 which would be the request for all the manuals, trial balance, list of activities, vendors, purchasing personal description, flow charts, management reports, internal auditor reports.
- Prepare 12 month schedule of account balances (or request that the company provide). Do the monthly activities tie to year end amounts?
- Review inventory pricing, with description of method used and when it was first adopted and its use consistent?



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Audit

- Have cash discounts been used and property applied?
- Has AFUCD been applied and correctly to construction work orders?
- Verify that physical inventory of each class of material and supplies is performed on a yearly basis. Obtain the audit report on physical inventory.
- Who does the physical inventory?
- Obtain and review any extraordinary or unusual adjustment made during the year under review.



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Audit

- Determine whether procedures for accounting for reusable materials, scrap and unusable materials are in compliance with the Uniform System of Accounts.
- Evaluate the reasonableness of procedures used to allocate the cost of labor and other expenses incurred in the purchase, receipt and issuance of materials and supplies to the cost of same.
- Be alert for unacceptable balances in either #152-fuel stock undistributed, and #163 Stores undistributed.



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Audit

- Prepare flow chart of inventory system. Can be prepared and provided by Company, but auditor will have to sit down with manager of procurements to walk through flow chart so auditor understands and is assured that employees and manager understand procedures.
- If there is time it is suggested that auditor participate in a field trip to warehouse or stores in different areas of the Utilities service territory. Be assured that procedures are also being followed outside the main offices of the company.



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Audit

- In preparation for a field audit it is suggested that the continuing property records also be reviewed, a sample of plant assigned to a work order can be located in the field. Other such checks can be made for materials recently obtain and still in receiving area or at a construction site.
- The continuing property records (see Friday's session) are useful for information for the audit to verify physical existence of plant and materials.



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Audit

- Physical existence of material, supplies and plant are important audit areas. This would include some following of fuel stock, operating supplies, merchandise, BUT probably not nuclear fuel!
- Nuclear Fuel area can be audited from desk. Invoices for purchase, processing, in stock and in reactor can be followed on paper as well as Spent fuel. The associated accounts booked can also be reviewed as well as the payment and depreciation of same on the books. Security controls are important.



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Purchasing Department

- Request is made. On a numbered form from authorized employee? Does employee have a dollar limit on his authority to request?
- If the limit is over what the requesting employee has the authority to request does it go to higher level?
- Does the request need to go to the risk management level?
- Request meets requirements so continues to Purchase order to be analyzed further for direction



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Purchasing department

- Does it need further approval, does it require a bid, or would vendor on records be suitable.
- Is the purchase order include proper authorizing signature?
- What is next procedure?
- Supplier is contacted and requisition along with purchase order goes to payables and receiving departments. Receiving has quantity and unit price blacked out.
- Information entered into data base system



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Purchasing department

- Is a contract involved?
- Do invoice rates match contract rates?
 - If not the vendor needs to be contacted
 - Request correction of invoice
- Does further approval necessary if there is a problem with invoice price and contract price?
- If invoice price is approved, send on to Accounts Payable department.



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Accounts Payable Department

- Did they receive an invoice and does it agree with purchase order?



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Auditor as an investigator

- There can be a difference between an accountant and an auditor. Both understand accounting rules
- An auditor, having the intelligence that the accountant has, also has to have a natural sense of curiosity.
- Auditor has rules, guidelines & plans to followed but must always look around and understand possible areas that require more examination. They need to be open to areas that are not in audit plan. Or areas that require more study and evaluation.



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QUESTIONS?