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# Procurement Audit Program

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# Audit Planning

- During the audit planning, the program should be customized for the type of materials and services acquired through purchasing
  - For example: purchasing raw materials differs from finished goods, which differs from services
- Audit planning should also take into account the adequacy of general controls within the department if parts of the purchasing application are computerized.

# Audit Program Steps

- Preliminary Survey
  - During the preliminary survey, the auditor should gain an understanding of how purchasing occurs within an organization.
  - Purchasing is a major expenditure of any business and critical to a businesses success

# Auditor objectives in reviewing purchasing

1. Purchasing function is performed in accordance with management's policies and procedures
2. Purchasing is performed in an effective, efficient, and economical manner
3. Purchasing function protects the best interests of the company in getting the highest quality product at the lowest price
4. Purchasing function ensures continual supply of needed materials
5. Procedures are established to validate that what has been ordered is received before financial settlement
6. No undue influence by vendors to get order, or no favoritism shown to vendors unless warranted through product quality and price

# Understanding Purchasing Systems

- The auditor should understand the purchasing system and its relationship to the other parts of the procurement system.
  - Any automated purchasing systems should be reviewed in order to identify any potential new or unique control weakness that may have resulted from the use of outdated technology.
- To understand the purchasing system: An Auditor should....
  1. Review the department policies and procedures including any conflict of interest or morality policies
  2. Request a purchasing walk-through from a senior member in the purchasing department
  3. Prepare a computer system flowchart and review it with the data processing project leader
  4. Identify the various types of purchasing transactions and document the flow of those transactions throughout the organization

# Purchasing Risks

- Purchasing is a high-risk area subject to fraud and abuse
- The system is one of the major sources of cash disbursement in the company
  - Easy area for collusion and favoritism, including kickbacks and favors from vendors
  - Extensive and regular audits are one of the stronger methods that can be used to reduce those risks
- There are also risks associated with the use of computer technology.
  - Generally, the more highly automated the purchasing system, the higher the technical risks.

## Risks associated with Purchasing Function Include:

- Purchase order information may be incorrect
  - Item, quantities, or other information relating to the order may be incorrectly recorded on the input document
- Unauthorized purchases may be made
  - Employees may obligate the company for products for which they do not have the authority to purchase
- Purchasing systems may be defrauded or abused
  - Employees may order items for personal use or that are not needed to conduct business
- Adjustments to vendor accounts may not be properly authorized
  - Returned merchandise, changes to orders and other adjustments to the vendor obligation may be made and often lacks proper supervisory approval
- Goods, assets, and other services may not be accounted for on a timely basis
  - The accounting record keeping may not be recorded in the accounting system in a reasonable period.

## Risks associated with Purchasing Function Include: Continued

- Inadequate division of responsibilities between purchasing, receiving, and accounts payable may permit fraud or abuse of the system
- Duplicate payments for purchases may be made
- Unauthorized goods or services may be accepted by the company and, thus, obligated the company to pay for unwanted items
- Purchasing function may not be operated in an efficient, effective, and economical manner
- Purchasing audit trail may be inadequate so that the department is unable to reconstruct processing
- Purchasing activity may not meet the needs of the company
- Purchasing activity may not receive adequate supervisory review to ensure its propriety



# Audit Evidence

- The control over purchasing evidence should be at the purchase order level. Maintaining control totals of computer files does not provide insurance that there are not large unrecorded liabilities
- The auditor should look for evidence at the lowest level and follow that evidence as it is accumulated to the general ledger

## Common purchasing audit evidence Includes:

- Purchase Orders
  - Document initiating the acquisition of materials and services
- Purchasing manual
  - Policies and procedures of the organization regarding purchasing
- Vendor lists
  - Lists of authorized vendors to contact for purchasing
- Purchase file
  - List of outstanding purchase orders
- Receiving documents
  - Indication of goods received, this should reconcile to purchase orders
- RPQ's or RFP
  - Requests for price quotation/Request for proposals
  - Documents asking vendors to bid on particular item

## Common purchasing audit evidence Includes: Continued

- Advertisements and solicitation letters
  - General requests to all vendors to bid on a particular item or service
  - Differs from RPQ because those are typically directed a specific vendors
- Vendor Proposals
  - Offers from vendors in response to RPQ's and other solicitations
- Vendor Catalogs
  - Listing of the products and the prices at which vendors offer products and services
- History file
  - Recordings of past vendor activity
- Adjustments and write-offs
  - Changes made to purchase order and other documents
- Purchase file totals
  - Totals over items in the purchasing file, independently maintained totals, or both

# Internal Control Assessment

- Strong Internal controls are needed because of the high risk associated with purchasing activity
- The auditor should first identify the high magnitude purchasing risks in an organization and then look for the key controls that will reduce those risks to acceptable levels.
  - If controls are missing or inadequate, the auditor should do extensive testing because of the high-risk nature of purchasing

# Common Key controls in purchasing Activity:

- Pre-numbered purchase orders
  - Number should be used to control the process and insure all orders are accounted for. Logs should be maintained of these numbers and missing numbers investigated
- Multilevel purchasing approvals
  - Dollar limits for purchasing authorizations. As one limit is reached, either additional signatures or higher levels of management should be required to approve the order
- Centralized receiving
  - All items shipped to the company should go through a centralized area. The group receiving the document should not be the group that placed the order
- Matching receipts to purchase order
  - No item should be accepted by the company unless an approved purchase order is available
- Purchasing policies and procedures
  - Management's direction for the purchasing of products and services within the organization

## Common Key controls in purchasing Activity: Continued

- Performance standards against which purchasing performance can be assessed periodically during operation
- Strict policies against vendor gifts
  - Helps ensure independence in vendor selection
- Close purchase order file after payment
  - When a purchase order is paid, it should be closed or in some way deleted from the open purchase order file.
  - This prohibits duplicate payments

## Audit Tests

- The objectives of testing should be:
  - To substantiate that controls are in place and effective (compliance testing)
  - To probe the magnitude of potential control weaknesses (substantive testing)
  - To evaluate the operational effectiveness of the purchasing function
- The type and scope of audit testing should be based on the auditor's assessment of the internal control system.
  - If the auditor cannot rely on the internal controls, heavy substantive testing may be required. The stronger the controls, the fewer necessary tests

## Planning Tests for purchasing Activity:

- Compare purchase order prices with vendor catalogs
  - Variances of significant differences should be investigated
- Sort payment file by vendor number and amount
  - These should be investigated to determine if there are duplicate payments for the same invoice
- Spot check receiving
  - Periodically, examine products being received by the company
    - This verifies the items received have been ordered
    - Verifies that the items received are consistent with what a normal business orders



## Planning Tests for purchasing Activity: Continued

- Probe for favored vendors
  - Purchase order file sorted by vendor number
    - Frequency of vendor orders should be accumulated and ranked
    - Vendors receiving large amounts of orders should be investigated to determine that price and service offered is competitive with other vendors
- Validate adequate segregation duties
  - Document the duties of individuals and analyze the results to make sure adequate segregation exists

## Planning Tests for purchasing Activity: Continued

- Compliance to procedures
  - Select a random number of purchase orders to verify that all of the appropriate procedures were complied with in processing and recording the purchase order
  - Verify that the requestor has proper authorization to order the products
  - Check the vendor invoice for the following
    - Clerical accuracy
    - Proper dates
    - Propriety of account distribution
    - Appropriateness of purchase

## Planning Tests for purchasing Activity: Continued

- End-of-month liability analysis
  - Items entered as liabilities immediately following the end of the accounting period should be examined to determine whether they have been recorded in the proper accounting period.
- Purchase needs audit
  - Objective is to determine whether the item purchased already exists in the company and could be used without repurchasing

## Cash Disbursements

- Is sufficient evidence required for all disbursements (except nominal amounts)?
- Are proper authorization and approval required prior to payment?
- Does the approval include approval of prices?
- Must the receipt of goods be approved prior to payment?
- Does the approval process cover the footings, extensions, discounts, etc.?
- Is the approval graduated according to the amount disbursed?
- Does the individual approving disbursements sign or initial the document?
- Is the accounting distribution of expenses included with the request for payment?

## Cash Disbursements - Continued

- Are the rules for automatic payment in computer programs approved by management prior to implementation?
- Is the functioning of automatic disbursement programs tested by an independent party?
- Can changes be made to automatic disbursement programs without proper approval of management?
- Are rules in automatic disbursement programs adequate to prevent duplicate payment of invoices?
- Are payment generated from computer programs reviewed by supervisory personnel prior to distribution?
- Are all checks pre-numbered?
- Are all pre-numbered checks accounted for on a regular basis?

## Cash Disbursements - Continued

- Do established procedures ensure that computer programs will not pay the same group of invoices twice?
- Are all mutilated and voided checks retained for proper accounting of pre-numbered checks?
- Are all checks stored in a secure area?
- Do at least two people have custodial responsibilities for negotiable checks (one checking on the other)?
- Are signature plates under the control of someone other than the individual given check-signing accountability?
- Does the individual having check-signing responsibility review the use of the signature plates?
- Is a log maintained over the use of signature plates?

## Cash Disbursements - Continued

- Are checks disbursed by someone other than the individual who authorized payment?
- Are checks used in numeric sequence?
- Are individuals with check-signing responsibility prohibited from signing blank checks?
- Are the supporting documents for payments voided or cancelled following payment?
- Are advance payments to employees properly authorized and controlled?
- Does the cash disbursement policy prohibit drawing checks to “cash” or “bearer”?
- Are all complaints of late or incorrect payment sent to a person independent of those having cash disbursement responsibilities?

## Cash Disbursements - Continued

- Do procedures require cash advances to be returned by transferred or terminated employees before they can receive their final paychecks?
- Are travel expenditures monitored to determine that they are in line with other employees' and reasonable for the area of travel?
- Are unusual uses of organization funds investigated?
- Is trend analysis performed on expenditures made by key employees and by vendor?
- Are employees with cash disbursement responsibilities required to take their scheduled vacations?
- Are bank accounts reconciled by an individual independent of the disbursement responsibilities?
- Are periodic audits made of disbursement activities?



## Purchasing

- Is the purchasing department organizationally independent of the departments using that function?
- Are the responsibilities of the purchasing department clearly defined?
- Is the company policy on purchasing covered by a written manual?
- Is there a policy covering the relationship of other departments with vendors?
- Is the purchasing department consulted on favorable purchasing opportunities, economic ordering quantities, and revision of purchasing specifications?
- Is there a policy on making purchases locally where possible?
- Is there a policy on purchasing from users of company products?

## Purchasing - Continued

- Is the purchasing department responsible for a continual review of marketing trends, particularly on long-term contracts and contracts containing escalation clauses?
- Is there a general policy on approval of purchases?
- Are approval limits covered in written procedures?
- Are approval limits definitive as to amount and classification of expenditure?
- Are there policies regarding special approval for capital expenditures?
- Is there an approval policy in which the final cost of an order exceeds the amount originally estimated on the requisition or purchase order?
- Are approvals needed if changes are made in the quantity or specification of the original purchase requisition?

## Purchasing - Continued

- Is the purchasing department facility laid out to facilitate interviews with salespersons?
- Is there a purchasing policy as to the amount of an order on which bidding is required?
- Is there a procedure on requesting bids?
- Is there a form specified for bids?
- Is there a procedure to summarize bids and select a vendor?
- Are purchase orders pre-numbered?
- Is the purchase order form clear and complete so that the vendor understands all terms and conditions?
- Are blank purchase order forms protected?

## Purchasing - Continued

- Is the routing of copies of purchase order forms defined?
- Is each copy of the purchase order necessary?
- Are the purchase order forms designed for efficient and simple completion?
- Are procedures established on how orders will be shipped?
- If an order is divided among several vendors, is the explanation for that procedure documented?
- Can small orders such as magazine subscriptions and non-product items such as membership in organizations be processed by the ordering department?
- Are transportation charges verified?
- Are prices always included on the purchase order?

## Purchasing - Continued

- If a purchase order calls for a “cost-plus” agreement, is the method of determining how final charges will be determined specified?
- Are there procedures for trade-in arrangements?
- Are there reasonable procedures to identify possible sources of supply?
- Are there procedures governing the negotiations of long-term contracts?
- Are there procedures governing how sales and use tax will be handled (ordering in state versus ordering out of state)?
- Are all purchase orders accounted for?
- Do all requests for materials, supplies, and services require supervisor’s authorization?

## Purchasing - Continued

- Are all purchase orders reviewed by someone other than the individual preparing the purchase order (reasonableness of order and vendor selection)?
- Are procedures established so that vendors with poor quality or late delivery are identified to eliminate additional dealings with that vendor?
- Are all initial purchase contracts made by the purchasing organization?
- Do the buyers always select or authorize the source of supply on other than contract purchases?
- Do buyers obtain price quotations or bids from two or more suppliers on significant purchases if catalog or advertised prices are not available?
- Is there a practice that prohibits signing blank purchase orders?

## Purchasing - Continued

- Are all purchase orders cancelled after payment to avoid duplicate payment of the same invoice?
- Is authorization required to make changes to the purchase order file?
- Are there procedures to ensure that changes to purchase orders will be updated on the computer files?
- Are buyers rotated so that they do not deal with the same vendors year in and year out?
- Are purchasing actions processed on a timely basis?
- Are buyers prohibited from accepting gifts from vendors?
- Are vendor price lists regularly updated?
- Are there special emergency purchase order procedures?
- Does someone review emergency purchase orders on an after-the-fact-basis

