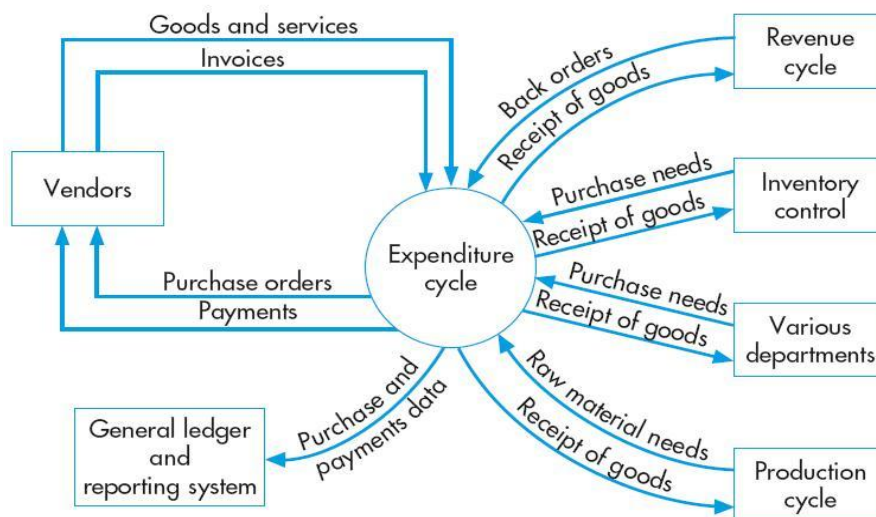# The Expenditure Cycle: Purchasing to Cash Disbursements

Learning Objectives

- Explain the basic business activities and related information processing operations performed in the expenditure cycle.
- Discuss the key decisions to be made in the expenditure cycle, and identify the information needed to make those decisions.
- Identify major threats in the expenditure cycle, and evaluate the adequacy of various control procedures for dealing with those threats.
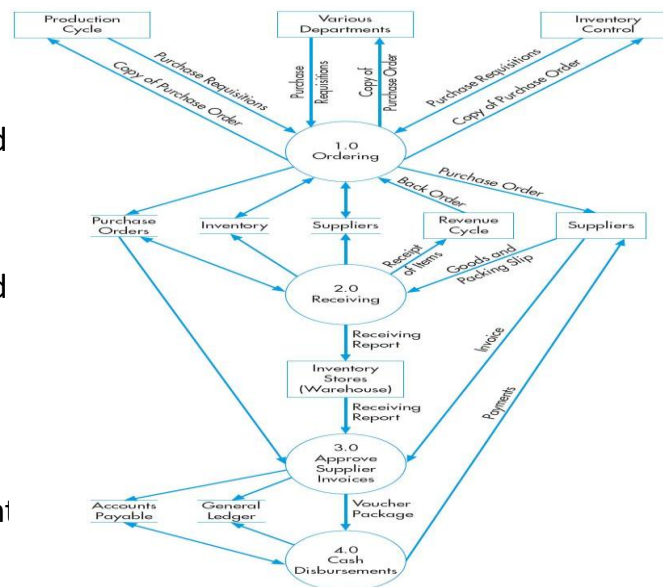
The Expenditure Cycle

The Expenditure Cycle

- Activities and information processing related to:
  - Purchasing and payment of
    - Goods and services
- Primary objective:
  - Minimize the total cost of acquiring and maintaining inventories, supplies, and the various services the organization needs to function

Expenditure Cycle Activities

1. Ordering materials, supplies, and services
2. Receiving materials, supplies, and services
3. Approving supplier invoices
4. Cash disbursement

Expenditure Cycle General Threats

- Inaccurate or invalid master data
- Unauthorized disclosure of sensitive information
- Loss or destruction of data
- Poor performance

Expenditure Cycle General Controls

- Data processing integrity controls
- Restriction of access to master data
- Review of all changes to master data

Ordering Threats

- Inaccurate inventory records
- Purchasing items not needed
- Purchasing at inflated prices
- Purchasing goods of inferior quality
- Unreliable suppliers
- Purchasing from unauthorized suppliers
- Kickbacks

Ordering Controls

- Perpetual inventory system
- Bar coding or RFID tags
- Periodic physical counts of inventory
- requisitions
- Centralized purchasing function
- Price lists
- Competitive bidding
- Review of purchase orders
- Budgets
- Purchasing only from approved suppliers

Ordering Controls (cont'd)

- Review and approval of purchases from new suppliers
- Holding purchasing managers responsible for rework and scrap costs
- Tracking and monitoring product quality by supplier
- Requiring suppliers to possess quality certification (e.g., ISO 9000)
- Collecting and monitoring supplier delivery performance data
- Maintaining a list of approved suppliers and configuring the system to permit purchase orders only to approved suppliers
- Review and approval of purchases from new suppliers
- EDI-specific controls (access, review of orders, encryption, policy)
- Requiring purchasing agents to disclose financial and personal interests in suppliers
- Training employees in how to respond to offers of gifts from suppliers
- Job rotation and mandatory vacations
- Supplier audits

Receiving Threats

- Accepting unordered items
- Mistakes in counting
- Verifying receipt of services
- Theft of inventory

Receiving Controls

- Requiring existence of approved purchase order prior to accepting any delivery
- Do not inform receiving employees about quantity ordered
- Require receiving employees to sign receiving report
- Document transfer of goods to inventory
- Use of bar-codes and RFID tags
- Configuration of the ERP system to flag discrepancies between received and ordered quantities that exceed tolerance threshold for investigation
- Segregation of duties: custody of inventory versus receiving

- Budgetary controls
- Audits
- Restriction of physical access to inventory
- Documentation of all transfers of inventory between receiving and inventory employees
- Periodic physical counts of inventory and reconciliation to recorded quantities

Invoice Processing

- Non-Voucher
  - Each approved invoice is posted to individual supplier records in the accounts payable file **and** is then stored in an open-invoice file.
  - When a check is written to pay for an invoice, the voucher package is removed from the open-invoice file, the invoice is marked paid, and then the voucher package is stored in the paid-invoice file.
- Voucher
  - Disbursement voucher is also created when a supplier invoice is approved for payment.
    - Identifies the supplier, lists the outstanding invoices, and indicates the net amount to be paid after deducting any applicable discounts and allowances.
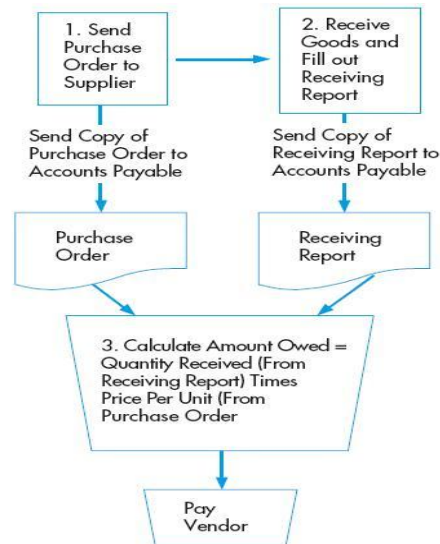
Advantages of Voucher System

1. Reduce number of checks
2. Can utilize pre-sequential-numbered voucher control
3. Allows for separation of invoice approval from invoice payment

Approving Invoices Threats

- Errors in supplier invoices
- Mistakes in posting to accounts payable

Approving Invoices Controls

- Verification of invoice accuracy
- Requiring detailed receipts for procurement card purchases
- Evaluated receipt settlement
  - Match PO with receiving report
- Restriction of access to supplier master data
- Verification of freight bill and use of approved delivery channels
- Data entry edit controls
- Reconciliation of detailed accounts payable records with the general ledger control account

1. Send Purchase Order to Supplier

2. Receive Goods and Fill out Receiving Report

Send Copy of Purchase Order to Accounts Payable

Send Copy of Receiving Report to Accounts Payable

Purchase Order

Receiving Report

3. Calculate Amount Owed = Quantity Received (From Receiving Report) Times Price Per Unit (From Purchase Order)

Pay Vendor

Cash Disbursement Threats

- Failure to take advantage of discounts for prompt payment
- Paying for items not received
- Duplicate payments
- Theft of cash
- Check alteration
- Cash flow problems

Cash Disbursement Controls

- Filing of invoices by due date for discounts
- Cash flow budgets
- Requiring that all supplier invoices be matched to supporting documents that are acknowledged by both receiving and inventory control
- Budgets (for services)
- Requiring receipts for travel expenses
- Use of corporate credit cards for travel expenses
- Requiring a complete voucher package for all payments
- Policy to pay only from original copies of supplier invoices
- Cancelling all supporting documents when payment is made

Cash Disbursement Controls

- Physical security of blank checks and check-signing machine
- Periodic accounting of all sequentially numbered checks by cashier
- Access controls to EFT terminals
- Use of dedicated computer and browser for online banking
- ACH blocks on accounts not used for payments
- Separation of check-writing function from accounts payable
- Requiring dual signatures on checks greater than a specific amount
- Regular reconciliation of bank account with recorded amounts by someone independent of cash disbursements procedures

Cash Disbursement Controls

- Restriction of access to supplier master file
- Limiting the number of employees with ability to create one-time suppliers and to process invoices from one-time suppliers
- Running petty cash as an imprest fund
- Surprise audits of petty cash fund
- Check protection machines
- Use of special inks and papers
- "Positive pay" arrangements with banks
- Cash flow budget