

PROCUREMENT PROCESS BUSINESS RISKS AND CONTROLS

CONTROL OBJECTIVES

Reliability of Information

Purchase orders are properly authorized.

Purchase orders are accurately and completely prepared and recorded on a timely basis.

All purchase order transactions are reliably processed and reported.

Receipts of materials and supplies are recorded accurately and completely on the timely basis.

Receipts of materials and supplies are recorded accurately and completely on a timely basis.

All material/supply receipt transactions are reliably processed and reported.

Performance measurements used to control and improve the process are reliable.

Relevance of Information

Employees and management are provided the information they need to control the process of obtaining materials and supplies.

Operational Effectiveness and Efficiency

Materials purchased satisfy the company's requirements and needs.

Materials are purchased at an appropriate price.

Orders are placed on a timely basis.

Materials are received on a timely basis.

The receiving process is efficient and cost-effective.

Materials received are processed on a timely basis.

Materials received meet required quality standards.

Physical safe guards are adequate.

The receiving process is safe.

Compliance With Laws and Regulations

Materials are obtained in compliance with applicable laws and regulations.

Management Control

Management develops strategic business alliances with suppliers.

BUSINESS RISKS

Reliability of Information

Purchase Orders Are Properly Authorized

Risks:

- The company will make unauthorized orders for materials and supplies.
- The company will order materials and supplies from unauthorized vendors, or at the wrong prices or terms.
- Goods purchased will not meet quality standards.
- Unauthorized individuals will order and receive materials and supplies.

Purchase Orders Are Accurately And Completely Prepared And Recorded On A Timely Basis

Risks:

- Receiving will reject deliveries because there is no valid purchase order.
- The company will receive incorrect materials and supplies, or quantities of materials and supplies, and incur additional costs to return or store these goods.
- The company will obtain an inadequate supply of materials and supplies.
- The company will lose purchase orders. This will result in incomplete records of materials and supplies to be received.
- Management will be unable to determine unfulfilled purchase commitments.

All Purchase Order Transactions Are Reliably Processed And Reported

Risks:

- Unauthorized changes will be made to programs. This will cause unauthorized processing results.
- Unauthorized versions of files and/or programs will be used to process transactions. This will result in unauthorized or incorrect business transactions.
- Files (transaction, reference or master) will be lost, altered or damaged. This will result in inefficiencies, lost assets, or incorrect processing of transactions.

Receipts Of Materials And Supplies Are Properly Authorized

Risks:

- The company will accept materials and supplies for which no authorized order has been placed.
- The company will accept incorrect, or excessive quantities of, materials and supplies, and materials and supplies which do not meet company specifications.
- Unauthorized individuals will order and receive materials and supplies.
- The company will receive and pay for, rather than return or refuse:
 - Unordered materials and supplies,
 - Excessive quantities or incorrect items, and
 - Canceled or duplicated orders.

Receipts Of Materials And Supplies Are Recorded Accurately And Completely On A Timely Basis

Risks:

- The company will not record, or inaccurately record, receipts of materials and supplies. Liabilities will not be recorded and inventory and cost of goods sold will be misstated.
- The company will lose the records of materials and supplies received.

All Material/Supply Receipt Transactions Are Reliably Processed And Reported

Risks:

- Unauthorized changes will be made to programs. This will cause unauthorized processing results.
- Unauthorized versions of files and/or programs will be used to process transactions. This will result in unauthorized or incorrect business transactions.
- Files (transaction, reference or master) will be lost, altered or damaged. This will result in inefficiencies, lost assets, or incorrect processing of transactions.

Performance Measurements Used To Control And Improve The Process Are Reliable

Risks:

- Inaccurate measurements will result in erroneous perceptions about process performance. This will result in inappropriate decisions.

Relevance of Information

Employees And Management Are Provided The Information They Need To Control The Process Of Obtaining Materials And Supplies

Risks:

- Employees and management will not be able to accurately determine whether the process is in control (i.e., that it is operating as planned).
- Employees will not be able to improve the process on a timely basis.
- Information provided to employees and management about the process will conflict with the company's objectives.
- Plans to improve the process will be based on incorrect perceptions of process performance.

Operational Effectiveness and Efficiency

Materials Purchased Satisfy The Company's Requirements And Needs

Risks:

- Products ordered will not meet the necessary technical specifications or quality standards.
- Materials will be received too early or too late. This will result in business interruptions and/or excessive levels of inventory.
- Vendors are not aware of the company's needs or are not able to supply the necessary materials.

Materials Are Purchased At An Appropriate Price

Risks:

- Product costs will be higher than anticipated.
- Products will not be profitable nor able to compete in the market at a reasonable price.

Orders Are Placed On A Timely Basis

Risks:

- Excessive inventory levels will increase costs.
- Insufficient quantities of materials will cause production delays.
- Orders will not be placed in sufficient time to account for vendor lead times.
- Late deliveries will result in business interruptions.

Materials Are Received On A Timely Basis

Risks:

- The company will not receive goods in time for production needs.
- The company will receive goods prior to production needs. Storage space will not be available.

The Receiving Process Is Efficient And Cost-Effective

Risks:

- The receiving process will incur higher labor costs than necessary.
- The organization of the receiving area does not allow for optimum storage of goods, nor for the efficient movement of goods from receiving into warehousing or production.

Materials Received Are Processed On A Timely Basis

Risks:

- Materials required for production will arrive, but end users will remain unaware of the receipt.
- Plans and schedules for goods to be received are not communicated to the receiving department.

Materials Received Meet Required Quality Standards

Risks:

- The company will encounter production problems because materials received do not meet quality standards and specifications.
- Production will be delayed if accepted materials are later found to be unusable.
- The company will incur additional costs of returning unacceptable goods at a later date.

Physical Safeguards Are Adequate

Risks:

- Materials and supplies will be lost, stolen, damaged, destroyed, used for unauthorized purposes, or temporarily diverted.

The Receiving Process Is Safe

Risks

- Accidents will occur in which employees are injured or facilities are damaged.
- The company will not comply with regulatory requirements.

Compliance With Laws and Regulations

Materials Are Obtained In Compliance With Applicable Laws And Regulations

Risks:

- The company will incur fines or other penalties.
- The company will make sensitive payments, violate export controls, and/or incur conflict of interest situations.
- The company will incur bad publicity and loss of reputation.

Management Control

Management Develops Strategic Business Alliances With Suppliers

Risks:

- The process will not achieve optimal results.
- The company will lose competitive advantage to those competitors that are able to increase efficiencies with their suppliers through technology links and joint cooperation.
- Adversarial approaches will lead to sub-optimal results for both parties.

INTERNAL CONTROLS

Reliability of information

Purchase orders are properly authorized.

- The requesting department is required to prepare the purchase requisition for all materials and supplies purchased.
- Requisitions are approved before purchase commitments are made. Vendors, prices, quality, quantities, and terms are approved.
- Computer system input screens and routines are used to generate purchase order documents/transactions.
- Computer system routines have been designed to automatically verify that purchase orders are created only for authorized vendors (e.g., the system automatically verifies the vendor against the vendor master file during purchase order entry).
- Purchasing personnel are provided with current prices, vendors, specifications, and terms (e.g., a supplier extranet site or computer inquiry terminals that have direct access to vendor product and inventory record files are used) to ensure that only authorized terms are used to create purchase orders.
- All purchasing responsibilities are segregated (including supplier selection) from disbursement and accounting activities.

- Purchasing agents or buyers are periodically rotated among purchasing responsibilities to ensure independence. If business conditions make it impractical to rotate agents or buyers, other compensating controls are implemented.
- An approved vendor master file is used by the system for verifying approved vendors during purchase order creation.
- New suppliers are added to the established master file only if they meet the criteria established by management.
- Suppliers are investigated prior to approval. Such factors as price competitiveness, reputation, product quality, delivery abilities, and financial solvency are considered.
- Competitive bids are obtained for all purchases over amounts specified by management.
- Justification and management approval are required for the absence of competitive bids or for the acceptance of a price other than a lowest bid.
- Computer system controls, such as access control software, are installed to preclude unauthorized purchase transactions.

Purchase orders are accurately and completely prepared and recorded on a timely basis.

- Computer system routines or prenumbered purchase order forms are used to assign purchase order numbers to order requests.
- Prenumbered forms are safeguarded from unauthorized use.
- Appropriate personnel (e.g., the original requestor) review generated purchase orders to ensure that items ordered are correct.
- Computer system routines are used to generate exception reports to identify purchase orders that have been outstanding for excessive lengths of time.

All purchase order transactions are reliably processed and reported.

- Authorization is required for all changes to program routines.
- User approval is required for program change test results.
- Tape and/or disk management systems are used to ensure that appropriate versions of transaction files, master files, and programs are used for processing.
- Computer system controls, such as access control software, have been installed to preclude unauthorized changes in the versions of files and programs used to process transactions.
- Computer system controls, such as access control software, have been installed to protect files and programs from unauthorized use, modification, or deletion.

Receipts of materials and supplies are properly authorized.

- Only materials supported with an authorized purchase order or its equivalent are accepted.
- All other receipts are returned to the supplier, or they are investigated for propriety in a timely manner.

- Computer system routines are used to verify that the material orders received are for legitimate outstanding purchase orders (e.g., match the purchase order number entered as part of the receiving transaction with records contained on the purchase order master file).
- The computer application is used to generate exception reports for any material receipts for which there is no outstanding purchase order on file.
- Computer system controls, such as access control software, have been installed to preclude unauthorized entry of receiving transactions into the system.
- Receiving reports are safeguarded from theft, destruction, and unauthorized use.
- Authorized personnel are designated to correct errors in original receiving reports and reenter them into the system.

Receipts of materials and supplies are recorded accurately and completely on a timely basis.

- Incoming goods are test counted, weighed, or measured on a sample basis to determine the accuracy of the suppliers' shipments.
- All discrepancies are noted on the receiving reports, and these discrepancies are resolved with the supplier.
- Incoming goods are inspected for damage, quality characteristics, product specifications, and so on.
- Receiving documents or online computer input routines are used to record the actual receipt of materials and supplies.
- Reconciliation controls have been implemented to ensure that all receiving transactions are entered into the system if receiving documents are initially used to record receipts of materials and suppliers.
- Computer system routines are used to match each line item of the receiving transaction with the line items of the corresponding purchase order record.
- Computer controls have been installed that are designed to highlight discrepancies on exception reports and denote purchase orders on file with partial receipt indicators.
- Computer procedures have been designed to close purchase order records when all line items match and have been received.

All material/supply receipt transactions are reliably processed and reported.

- Authorization of all changes to program routines is required.
- User approval is required for program change test results.
- Tape and/or disk management systems are used to ensure that appropriate versions of transaction files, master files, and programs are used for processing.
- Computer system controls, such as access control software, are used to preclude unauthorized changes in the versions of files and programs used to process transactions.
- Computer system controls, such as access control software, are implemented to protect files and programs from unauthorized use, modification, or deletion.

Performance measures used to control and improve the process are reliable.

- Controls have been implemented to automatically calculate and process the performance measures based on data captured at the transaction source (e.g., processing time, number of defects, and on-time delivery).
- The measures are periodically reviewed to ensure that they reflect actual process performance.
- Quality reports and customer surveys are used to capture relevant information about process performance.
- The information captured is communicated to employees responsible for vendor relations and improving the procurement and receiving process.
- Management and employees understand the linkage between the measures and customer satisfaction.
- Management and employees buy in to the use of these measures as tools to improve process performance.
- The performance measures are linked with employees' performance evaluations.

Relevance of information

Employees and management are provided the information they need to control the process of obtaining materials and supplies.

- Approved suppliers are periodically and systematically monitored to ensure that their actual performance meets expectations. Performance measures may include percent of on-time delivery, accuracy of shipments, product quality, and actual cost performance compared with original cost projections.
- Purchasing agents, buyers, and cross-functional teams are evaluated in a manner consistent with management's objectives of reduced inventories, improved quality, lower costs, and frequent reliable deliveries.
- Appropriate performance measures are selected to ensure that the procurement and receiving processes are properly controlled.
- Quantifiable and controllable measures are selected that (a) link the process to the company's goals and to customer expectations and (b) will stimulate continuous improvement.
- The process used to collect the required data and calculate the measures is defined (e.g., define whether data collection is an integral part of the operating process or a separate process, and whether it is cost effective).
- Management understands how the procurement and receiving processes contribute to customer satisfaction and the overall company objectives.
- Selected performance measures support the creation of value and customer service by reflecting quality and time as well as costs.

Operational effectiveness and efficiency

Materials purchased satisfy the company's requirements and needs.

- The company investigates and periodically updates vendor capabilities regarding product line and product specifications, product quality, and capacity and order lead times.

- Procedures are specified for notifying vendors of potential performance problems and for appropriate investigation and follow through.
- Data is developed on alternative vendors, and the vendor selection decision is periodically reevaluated.
- Purchasing agents, buyers, and cross-functional teams are evaluated consistently with management's objectives of reduced inventories, improved quality, lower costs, and frequent reliable deliveries.
- Other measures are used to address issues such as supplier relationships, frequency of returned purchases, production problems related to out of stock materials, and quality problems.
- Vendor representatives are involved in product design and development.
- The approved suppliers are periodically and systematically monitored for just-in-time purchasing to ensure that their actual performance meets expectations. Performance reporting includes: percentage of on-time delivery, accuracy of shipments, product quality, and actual cost performance compared with original cost projections.

Materials are purchased at an appropriate price.

- A mechanism has been developed for determining the total cost of major purchases from particular vendors. Considerations should include: percentage of on-time delivery, accuracy of shipments, product quality, and actual cost performance compared with original cost projections.
- Purchasing is centralized within the company.
- Materials and supplies are ordered from one or a few vendors to maximize the benefits of volume purchases.
- Appropriate performance measures are used to monitor process performance, such as percentage of purchases made under a bid process, amount of volume discounts obtained, and actual cost performance compared to original cost projections.
- The performance of winning vendors and whether their pricing structures remain at competitive market rates is periodically evaluated.

Orders are placed on a timely basis.

- Communication channels are established between the marketing, production, and purchasing functions.
- Production schedules and material requirements are documented.
- Production needs are periodically reconciled with purchase orders and inventory levels to ensure they are adequately aligned.
- Long-term needs are analyzed and forward contracts are established with standing orders.
- The production scheduling system is integrated with the purchasing system.
- The computer system is used to generate purchasing requirements based on production schedules recorded in the purchasing system and on standard bills of material master files.
- The computer automatically generate purchase orders based on these material requirements, current stock levels and previously specified desired minimum stock levels.

- The company has at least considered using electronic data interchange (EDI) to place orders directly into the suppliers order entry system.

Materials are received on a timely basis.

- Just-in-time inventory techniques have been implemented.
- Supplier performance ratings have been developed, applied, and monitored.

The receiving process is efficient and cost-effective.

- The physical activities of the receiving process are reviewed.
- The receiving area and procedures are designed to reduce the number of activities and the time required to complete activities.
- Employees are trained in the process of materials handling.
- Employees are encouraged to share ideas and suggestions on ways to improve the process.
- Only limited storage space is allowed for within the receiving area to enforce the efficient distribution of goods away from receiving.

Materials received are processed on a timely basis.

- Production is notified when materials and supplies are received.
- Communication channels have been established between purchasing, production, and receiving to ensure all parties are aware of material needs and the timing of these needs.

Materials received meet required quality standards.

- Receiving personnel are trained in inspecting the quality of materials received, or materials are sent to trained personnel to ensure the materials meet the company's minimum standards for production use.
- Strategic alliances or partnerships have been developed with suppliers to ensure quality is built in by the supplier.
- The number of suppliers is optimized to achieve total delivered cost targets and meet specific customer needs.
- Strategic business alliances have been developed with suppliers.
- Suppliers are involved in the new product development and value analysis process.

Physical safeguards are adequate.

- Access to receiving and storage areas is restricted to authorized personnel.
- Receiving gates or loading docks are kept closed when no delivery is in process.
- Entry to facilities is checked, appropriate visiting documents are issued, and random checks of person are on the premises are performed.
- The receiving function is physically segregated from production facilities and shipping, unless good business practice dictates otherwise.
- Incoming goods are secured and safeguarded upon receipt.

- Appropriate handling and storage practices are communicated to employees to prevent damage to materials.

The receiving process is safe.

- Employees are fully trained in the safe handling and storage of non-hazardous materials.
- Procedures have been established for reporting and addressing safety concerns.
- Procedures and policies which comply with relevant rules and regulations concerning safety are maintained.
- Employees are fully trained in the safe handling and storage of hazardous materials.
- Hazardous materials are stored in appropriate containers.
- Hazardous materials are segregated from the main facilities used by employees.
- The handling and storage procedures and facilities are regularly inspected.

Compliance with laws and regulations

Materials are obtained in compliance with applicable laws and regulations.

- Legal review of all relevant laws and regulations is required.
- Procedures have been developed that comply with these laws and regulations.
- Industry organizations or regulatory bodies are consulted about compliance with laws and regulations and possible future requirements.
- The political, law making, and regulatory environment is monitored to ensure that the company's procedures remain in accordance with any industry standards and applicable laws and regulations.
- The company's policies and procedures concerning compliance with laws and regulations are documented.
- This information is distributed to appropriate personnel.
- A legal officer has been designated and is generally responsible for compliance with laws and regulations and is available to advise management.

Management control

Management develops strategic business alliances with suppliers.

- Strategic business alliances have been developed with suppliers. These suppliers are involved in developing better ways to process accounts payable.
- Vendor relations are continuously improved upon.
- Objectives have been developed to use in identifying potential candidates with whom the creation of strategic alliances makes sense.
- Due diligence reviews of potential vendors are performed .
- Partnership relationships are formalized and documented.
- In cooperation with strategic partners, the purchasing and accounts payable processes have been reengineered to eliminate redundancies.
- Integrated system technologies, such as EDI or web links are used to streamline the accounts payable process and to build linkages with strategic partners.

