

Counter intelligence

Auditors aren't just there to look over your shoulder. Neil Cowan explains how they can help procurement's performance:

Every process in any organisation has to add value or it will be dropped. But how can internal auditing, viewed traditionally as some kind of policeman or a fussy pedant, help organisations to run more effectively? And how can internal auditing make procurement a better performer?

For many firms, it is the value added between purchasing and the onward movement of goods or services that constitutes the profit margin. Therefore procurement strategy should be part of an organisation's broader long-term view. And, it should be set at the top.

Internal audit should be part of the senior managers' responsibility - guaranteeing strategy and objectives are achieved. But what is its role? Well, what it can't do is second-guess or supplant effective management. Rather, it assures senior managers that there is recognition of the risks which may prevent delivery of strategy.

Internal auditing also ensures that controls put in place to mitigate risk are operating as management expects. Modern internal auditors go beyond checking for compliance with policies and procedures.

Some of that may still be done to provide assurance, but the real added value from internal auditing comes from ensuring that the aim of objective risk control is understood and underwrites management actions.

Strategy for internal audit is driven by the board or governing body's need for assurance that all of the organisation's operations are proceeding as expected. In other words: minimising the unexpected.

Auditing procurement

The audit of the procurement process first seeks to establish that purchasing has been integrated with other organisational strategies and that key risks have been

recognised. These include the ability of the supplier to deliver the contract and keep the confidentiality of the deal. There needs to be legal compliance on both sides. The risk of the supplier not delivering to time or quality or actually going out of business should also be addressed.

Internal audit would prioritise its work in procurement by aligning its efforts with the high-risk areas management has identified. It would look for evidence that procurement staff understand their objectives and contribution to the strategic procurement plan.

Other areas of interest to audit could include reviewing tendering procedures or contract terms. Authorisation levels, how goods are received and retained, distribution systems and the interface with accounts payable will also feature.

Auditors will also seek evidence of value for money from the procurement process. This could be discounts taken and payments made at the optimum time and, in particular, from any warehousing, stock-holding or distribution function. They will ask what value is added and whether there is a better way of doing it.

The final link in the procurement chain is paying the supplier. The auditor looks for evidence of a system to match an authorised purchase with a supplier invoice and a document certifying receipt of goods or services. This can be either paper documents or template data entries on screen.

The auditor will also examine the authority to make payments and how it is exercised. Subsequent control of payment methods needs to be reviewed and evidence of frequent bank reconciliations is required.

Lastly, the auditor will want to review how total payments to suppliers are reported to senior management, together with the quality and frequency of financial management reports.

Red flag indicators

The purchasing process has traditionally been an area where fraud may occur and where bribery and corruption could flourish. Indicators and examples of the possibility of fraud or poor internal control include:

- Too close a relationship between procurement managers and suppliers - kickbacks can be in cash or kind, for example, exotic foreign holidays, free use of a car or theatre tickets.
- Poor tendering procedures - in particular, firms being favoured over others - can be seen in, for example, poor security of bids and conflicts of interest.
- Lack of delegation in the procurement function - senior buyers keep everything to themselves to avoid detection of bribes or even just poor margins being obtained.
- One supplier winning most of the business can indicate favouritism and no value for money.
- Favourable contract terms for suppliers can show poor value for money or evidence of corruption.
- Stock discrepancies may indicate straight theft or poor administration.
- Supplier demands for payment in cash.
- Individual rather than company names for suppliers.
- Frequent payments of the same amounts to one supplier (other than term payments, for example, electricity).
- Budget discrepancies.

Technology and risk

Advances in IT have allowed huge steps to be taken in the automation of the procurement function.

E-commerce or e-procurement simply means extensive use of data and electronic fund transfer (EFT) and controlled access to third-party IT systems. This leads to productivity gains for both purchasers and suppliers. For example, a

supplier's knowledge of a purchaser's stock levels can generate automatic re-ordering to agreed levels without operator intervention or documentation. Regular interim payments to a supplier can work in a similar way.

In-house procedures can make full use of technology gains by automating the bureaucratic and lengthy paper trail typical of older working practices. Using networked screens to generate and authorise everything from purchase orders through to an EFT improves efficiency and effectiveness that can ultimately cut running costs.

All of these technological advances help the auditor as well. Specialised software allows the auditor to test far greater numbers of transactions quicker than would previously have been the case and to report to management quickly and effectively.

There are significant benefits in using all of these systems. However, there are also large risks and the auditor needs to be aware of them, ensure that management has identified and assessed them and reached a risk level for e-commerce that is consistent with the organisation's strategy and objectives.

Procurement cards pose particular control problems as well as providing great benefits. The risks of splitting orders so as not to breach authority limits, personal purchases using company cards, use of the cards by unauthorised employees all need stringent management control.

The audit of the procurement process seeks to provide several assurances to the governing body. First, that procurement strategy is integrated with corporate strategy and objectives. Second, that significant risks have been identified and managed. Third, that internal control has been put in place as a risk mitigation strategy, and that it is adequate and effective.

Audit also seeks to give assurance that there is added value to the organisation in having a procurement function and that

alternatives have been explored. By working together, internal auditors and procurement can secure a better deal for both sides.

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