Case Study: Procurement Audit

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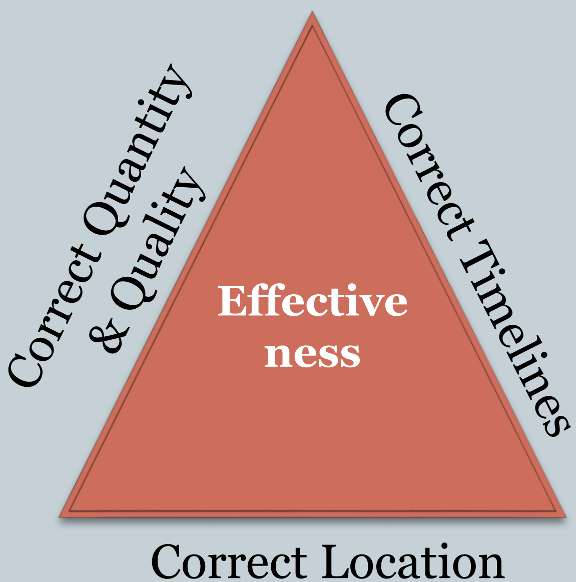
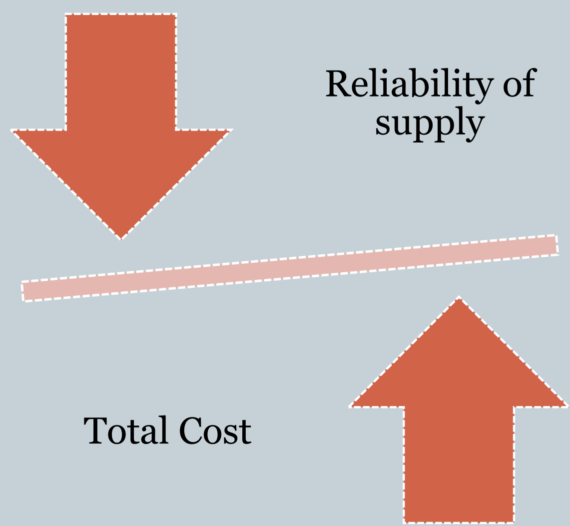
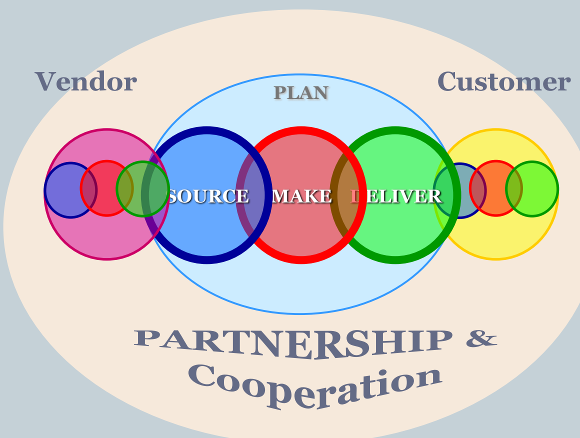
What is procurement?

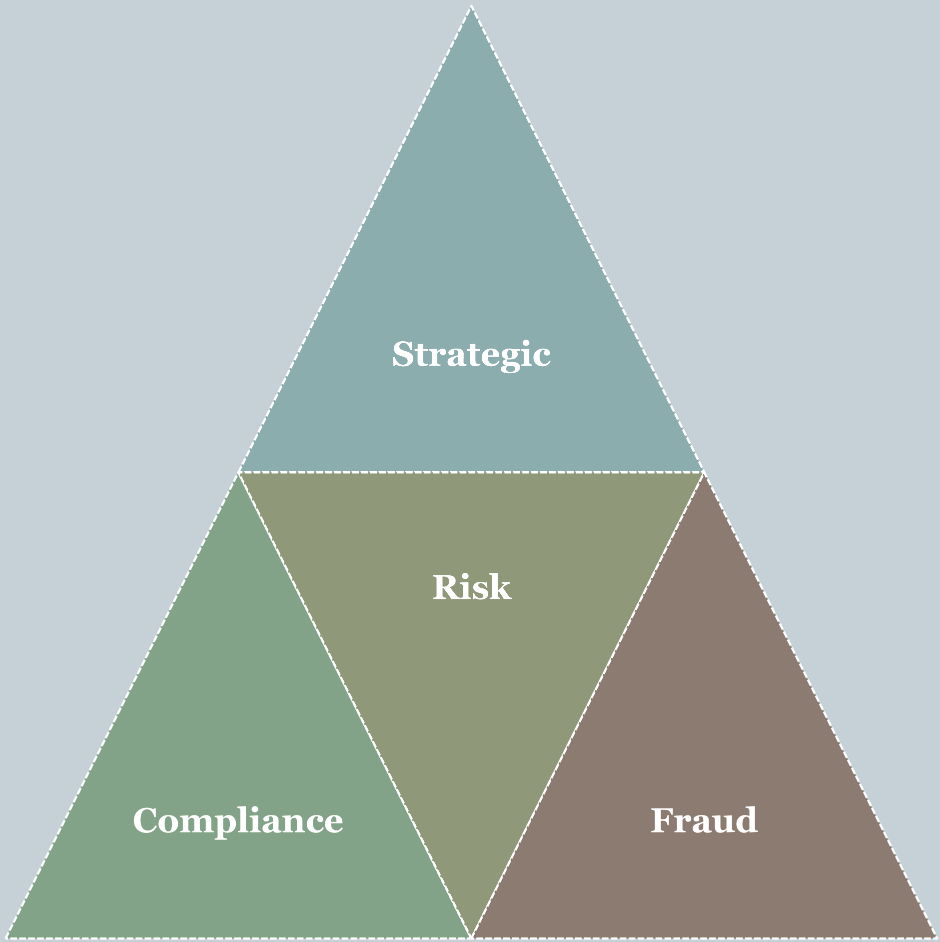
Process to obtain,
through Contractual Agreement,
Timely and Correct Delivery
of Goods and Services
at Best Value for Money



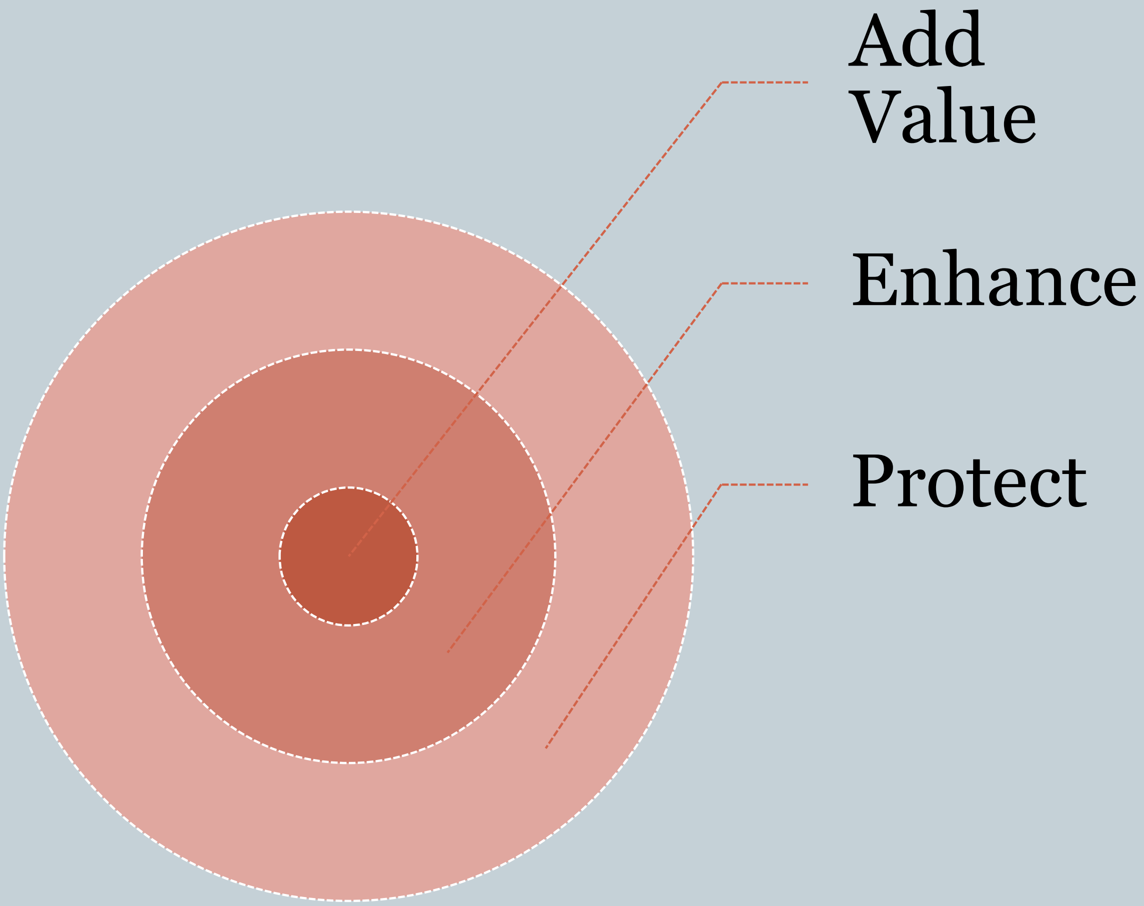




Why Procurement is so important for internal auditing?



Which is the IA role in procurement?

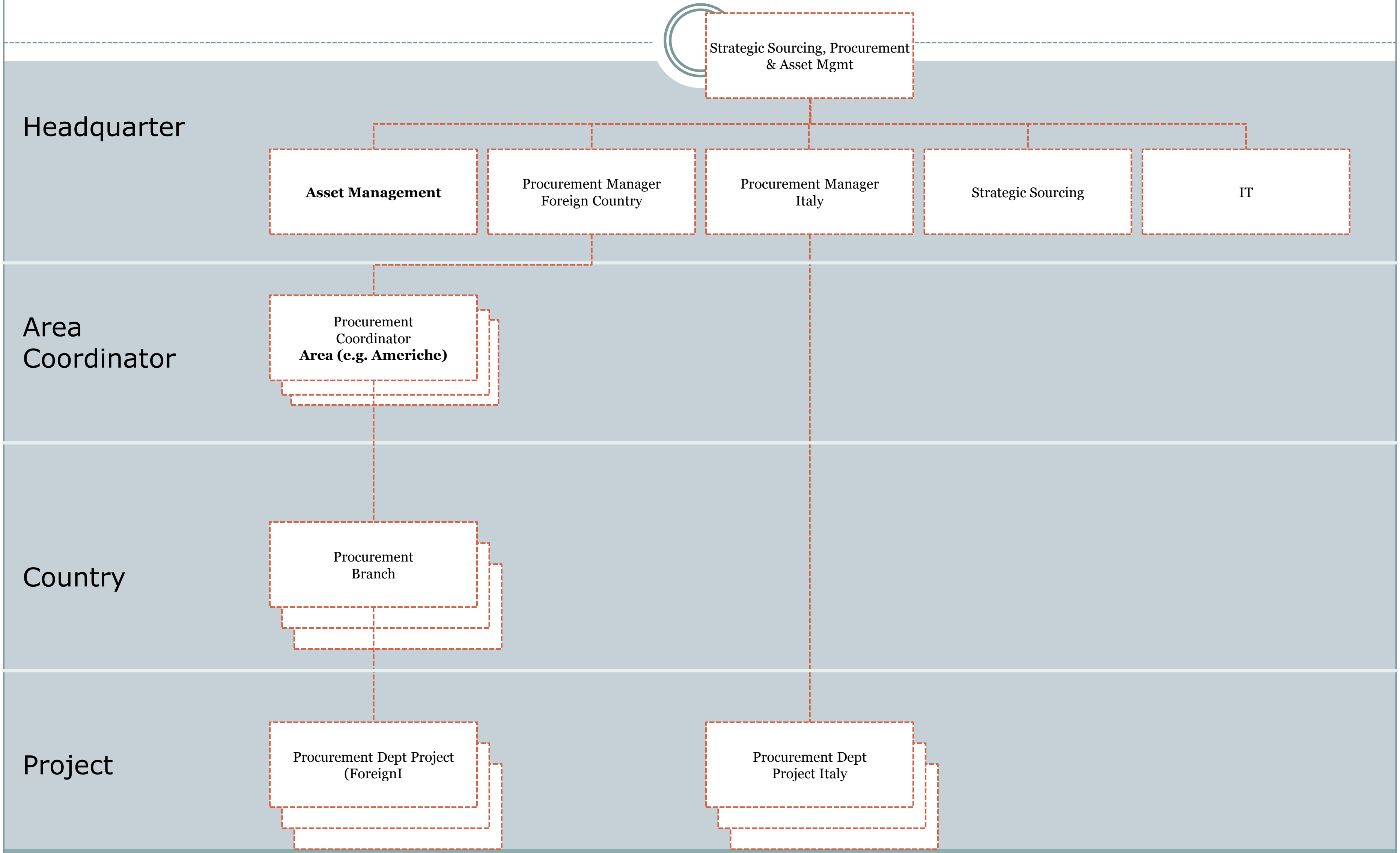


Procurement Cycle

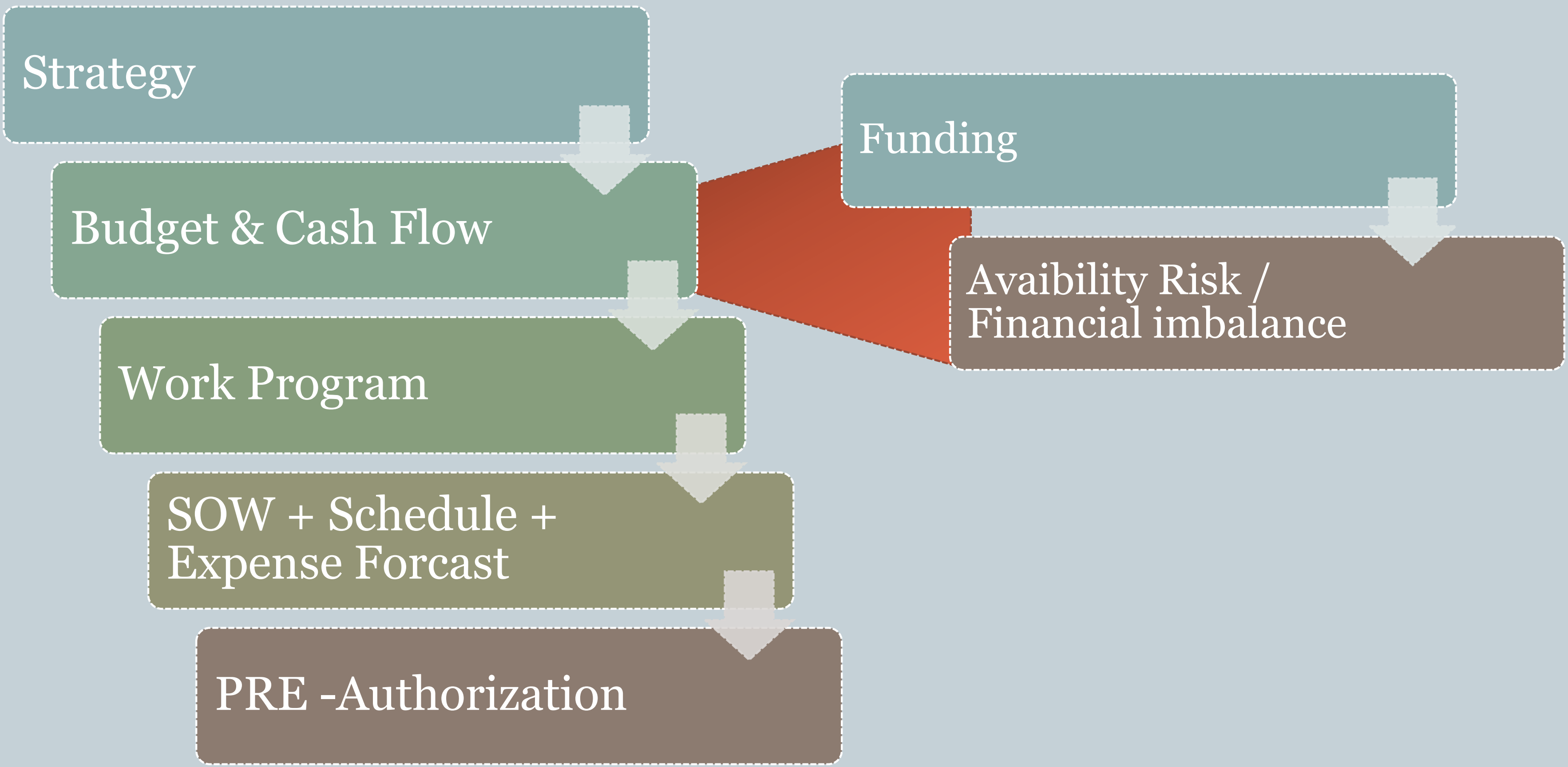
- Organization Procurement Plan
- Cash Flow Analysis
- Request for Procurement
- Identification of Potential Vendors
- Competition
- Request of bid / tender
- Technical and economic evaluations
- Negoziation
- Selection of the preferred vendor
- Award Of Contract
- Receipt and evaluation of goods and services
- Invoice Recording and Payment
- Performance evaluation

Which are main risks and controls of each phase?

Procurement Organization: an example



Procurement Plan & Cash Flow



Request for Procurement

Must contain all the technical elements (specific) relating to the object of purchase, the conditions required added (eg the delivery or performance of the program) and in general all the elements necessary for the initiation of proper market research

Description, Acceptance Criteria, Deliverables / Output, Exclusions, Constraints, Assumptions

Technical Specifications / Scope of Work (Annexes)

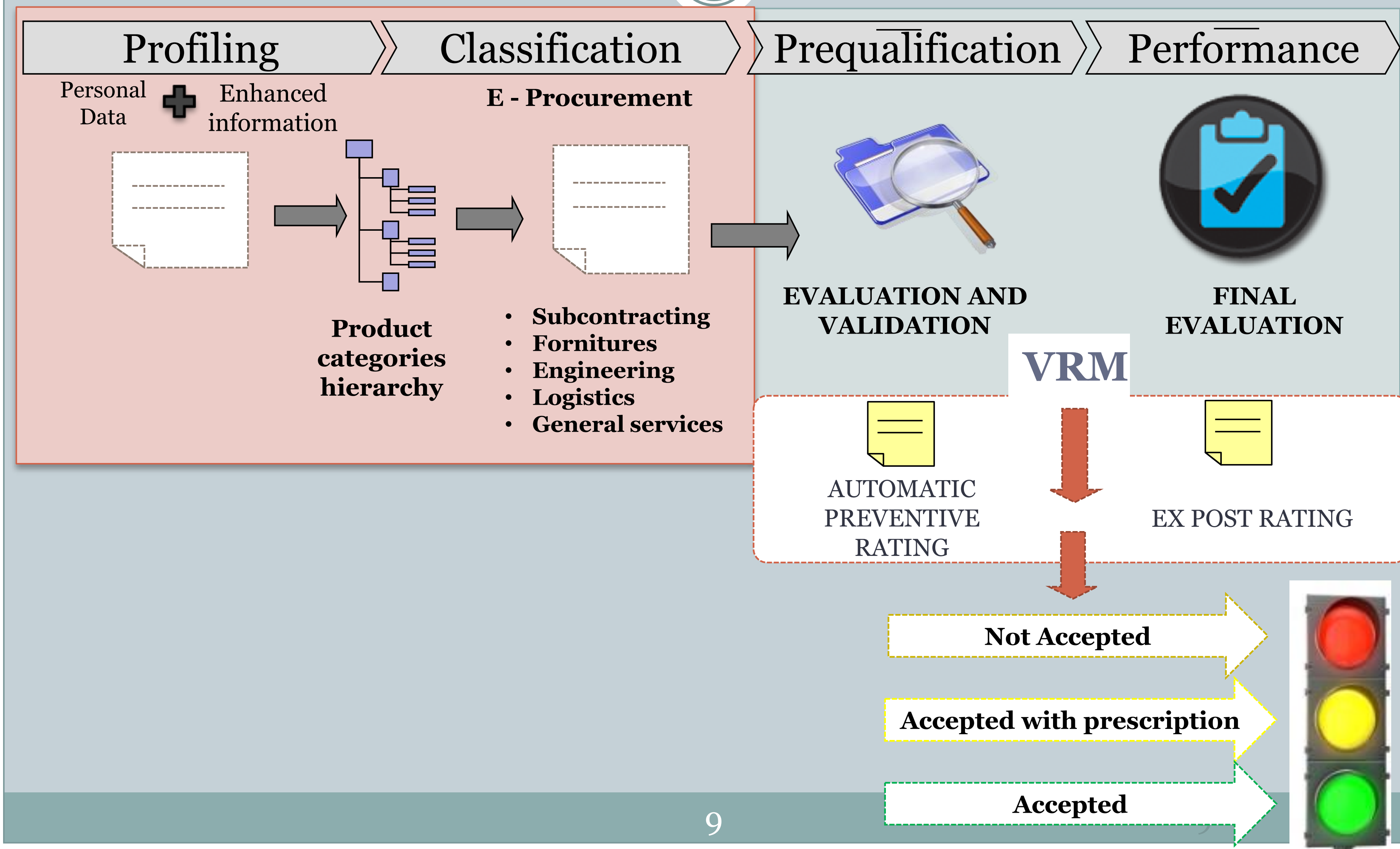
Trigger of procurement activities: formal request defined into a standard format / template

Issued by the END USER (note the Procurement Department / Buyer)

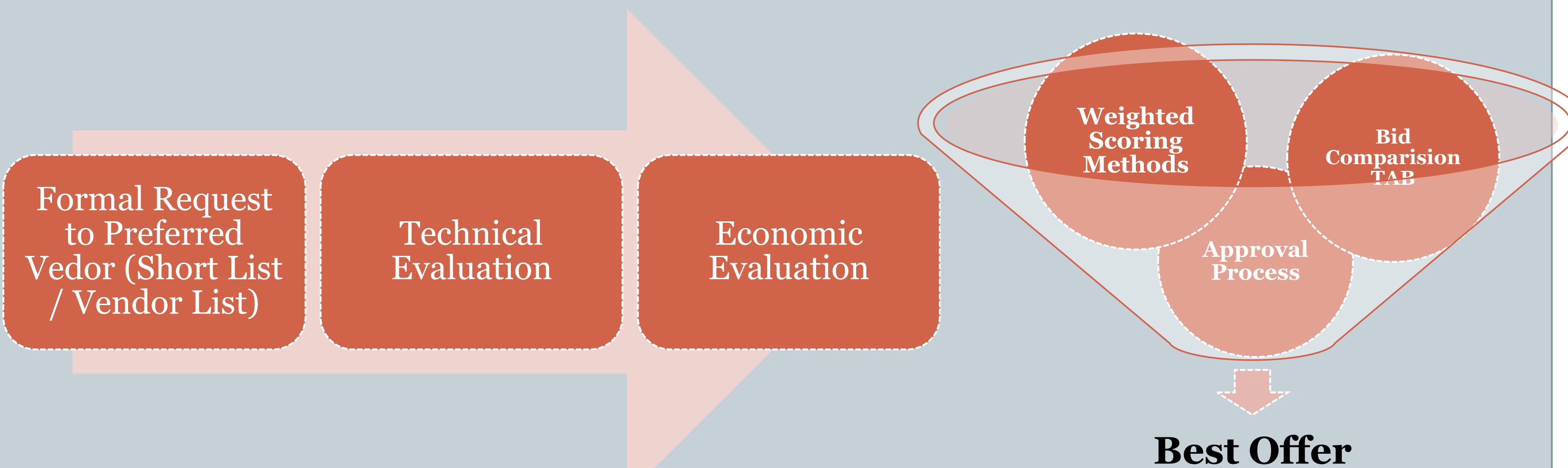
Purchase Request must include:

- ✓ description of goods / services;
- ✓ required amount / time extent;
- ✓ unit of measurement;
- ✓ in the case of assets, period of expected utilization;
- ✓ Budget availability ;
- ✓ Schedule and Location;
- ✓ Transportation requirements;
- ✓ date and signature of the Applicant;
- ✓ date and signature for approval of relevant Directorate;
- ✓ references to specifications, standards, drawings, etc .;
- ✓ certifications required (quality, safety, product, etc.)

Identification of Potential Vendors



Competition, Request of bid / tender, Technical and economic evaluations



Negotiations and Selection of the preferred vendor

Negotiation

Based on the results of the research, negotiation is limited a short list to vendor

Negotiation should involve Procurement Department, End Users and any other Activity affected by the purchase to be performed

Pre evaluation of procurement ricks through the involvement of other departments:

-Legal (Contractual & Compliace Risks)

- Cost Control (Budget Risks)

- Adm&Fin (Insurance, Liquidity and Credits, Financial Structure Risks)

- HSE (Safety, Enviroment, CSR Risks)

- ODV (deroghe a standard di controllo)

Selection

The negotiation phase culminates in the choice of supplier

Criteria for the choice of supplier are not limited to the "best price" but extend to the following cases (for example)

Minimum bid; Technical skills; Engineering capabilities and technological innovation; Financial management; Quality and HSE; 231 Compliance; IntuituPersonae; Presence in the Territory; Professional Specialization.

Award of Contract

Regolarity
Default
Documentation
Force Major
Confidenziality
Privacy
Assurance
Law
Labor requiremnts
Damages
Claim
Intellectual Property
Local Law
Foro Competente
Penalties
Parallel entitlement
Variation
Arbitration
Clausole vessatorie
Back to Back

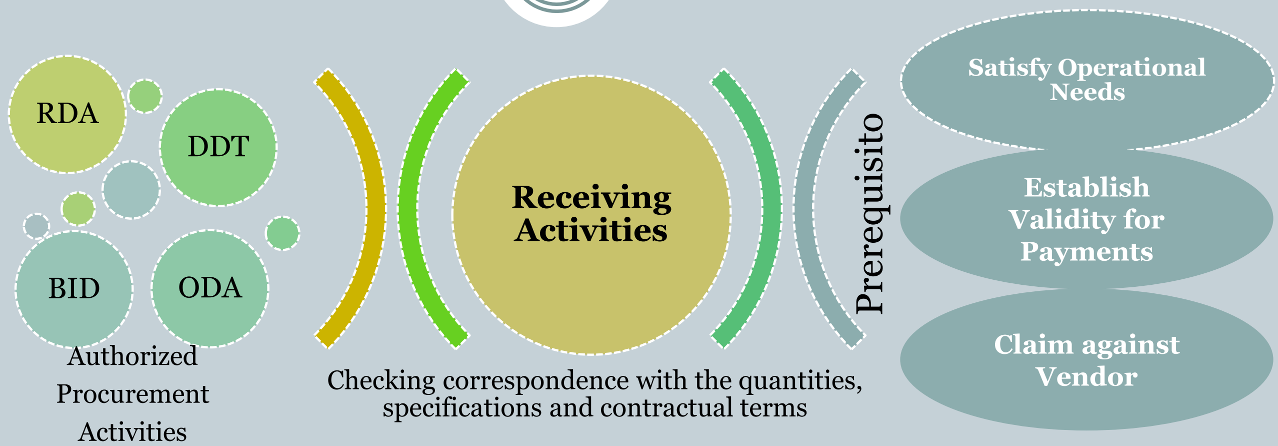
Purchase Order
- Goods/ Simple Services
- Preprinted Tample
- General Provisions

Framework Agreement
- Recurring goods
- Unit Prices Focused
- Delivey Schedule

Contract Agreement / Subcontrac
- Work activities
- Relationship based
- Tecnical Specification
- Claim Risk

- ✓ Purchase Orders and Contracts are prepared using standard models (typological) generally prepared by the Legal Services in collaboration with the Procurement
- ✓ Include clauses to safeguard the Company
- ✓ Describ the nature and specific characteristics of the object of contract
- ✓ Are signed by Proper Responsible
- ✓ Any exceptions made to the typological standard should be justified and approved later
- ✓ Contracts include the name of Manager for the management of the contract which is entrusted with the responsibility for the proper application of contractual clauses

Receipt and evaluation of goods and services



Receipt

All products supplied, upon arrival at the site, are subject to inspection upon receipt by the Manager of the Warehouse, with the support of any of the other functions of the job order.

In particular, the inspection on receipt essentially consists in verifying:

correspondence between quantity ordered and quantity received; correspondence between type of product ordered and delivered product; quality of the product; physical integrity; adequacy of the documents and / or certification; packaging conditions; identification criteria; Price Match between invoice and PO / Contract

Goods
- Inspections

Works / Services
- Valorization

Advisory
- BAP

Invoice Recording and Payment

- When the vendor delivers the items ordered, a Confirmation is processed and posted as a Goods Receipt (GR)
- The Invoice is received from the vendor and posted
- Payment is made once the invoice is matched to the PO and the goods receipt.

Goods Receipt =

Expense Acct	
DR	

GR/IR (Acc. A/P)	
	CR

Invoice Receipt =

GR/IR (Acc. A/P)	
DR	

Vendor Payable	
	CR

Three scenarios affect GR/IR

- Goods receipt without invoice receipt
- Invoice receipt without goods receipt
- Goods receipt AND invoice receipt, difference in quantity
- Invoices will be blocked for payment for one (or more) of three reasons on a line item basis:
  - Price is out of tolerance
  - Quantity is out of tolerance
  - Goods are not confirmed

Audit the Procurement Process

Each audit engagement aims to provide management with an independent and objective evaluation of

Main inherent risks are managed properly through control systems that limit the residual relevance within acceptable threshold

Risk management and internal control are operating in compliance with adopted organizational model

Therefore, there is a reasonable assurance of the achievement of objectives Or the need of corrective actions

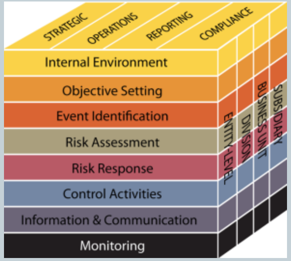
Governance

Combination of processes and structures implemented by the board to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives

- ✓ Ethical principles and values?
- ✓ Efficient organization and accountability?
- ✓ Information & communication on risks and controls?
- ✓ Coordination and information flows between Key Governance Actors?

Risk Management

Process, effected by board, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.



- ✓ Identification of objectives in line with mission?
- ✓ Evaluation of significant risks??
- ✓ Selection of risk response in line with risk appetite?
- ✓ Risk reporting?

Control

Process, effected by an board, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance

- ✓ Controls proportionated to risks?
- ✓ Controls in line with risk tolerance and acceptance?
- ✓ Reasonable assurance of achieving the objectives (strategic; reliability and integrity of information; effectiveness and efficiency of operations; Safeguard the assets; Compliance)?

Systematic, disciplined approach

For the pursuit of its mission, internal auditor should adopt a Systematic, disciplined approach structuring each engagement in a integrated process split into following basic steps:

- Preliminary Survey
- Detailed Assessment
- Audit Strategy Definition
- Field Work
- Finding Communication

Performance Standards

2200 – Engagement Planning

Internal auditors must develop and document a plan for each engagement, including the ***engagement's objectives, scope, timing, and resource allocations***

- Objectives of the activity
- Significant risks
- Adequacy of ERM& SCI
- Opportunity of improvememnts

Planning Considerations

What we are going to audit?

- Risk to be audited
- Criteria to be used
- Errors tollerance

Engagement Objectives

Where we should focus?

Engagement Resource Allocation

How to deal with budget constrains and assurance needs?

- Evaluation of nature and complexity of each engagement, time constraints, and available resources.

Engagement Scope

How to achieve engagement aims?

- Relevant systems, records, personnel, and physical properties

Preliminary Survey

Target	Get aware of main characteristics of the audited area
	Guide the planning of the engagement (objectives, scope and extent, work program)
	Identify potential risks and most critical areas, where audit should be focused
Metodology	Industry Competitive Position Anaysis
	Business Model Analysis
Output	Value Proposition

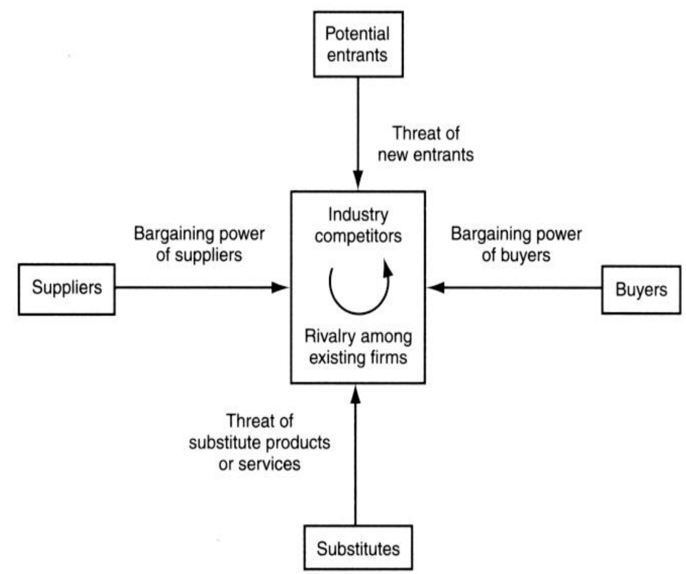


FIGURE 2-2 Porter's Five Forces Model

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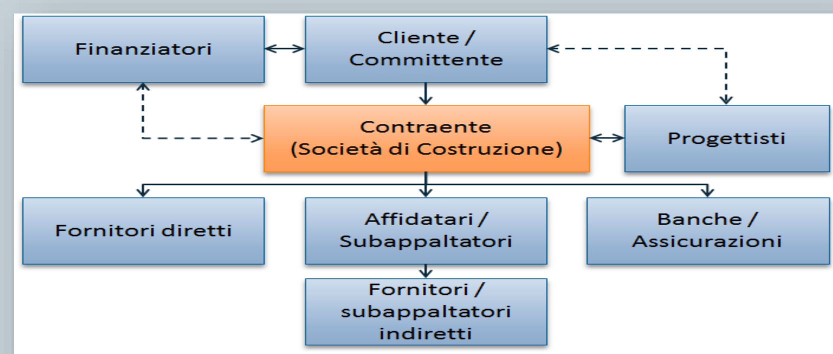
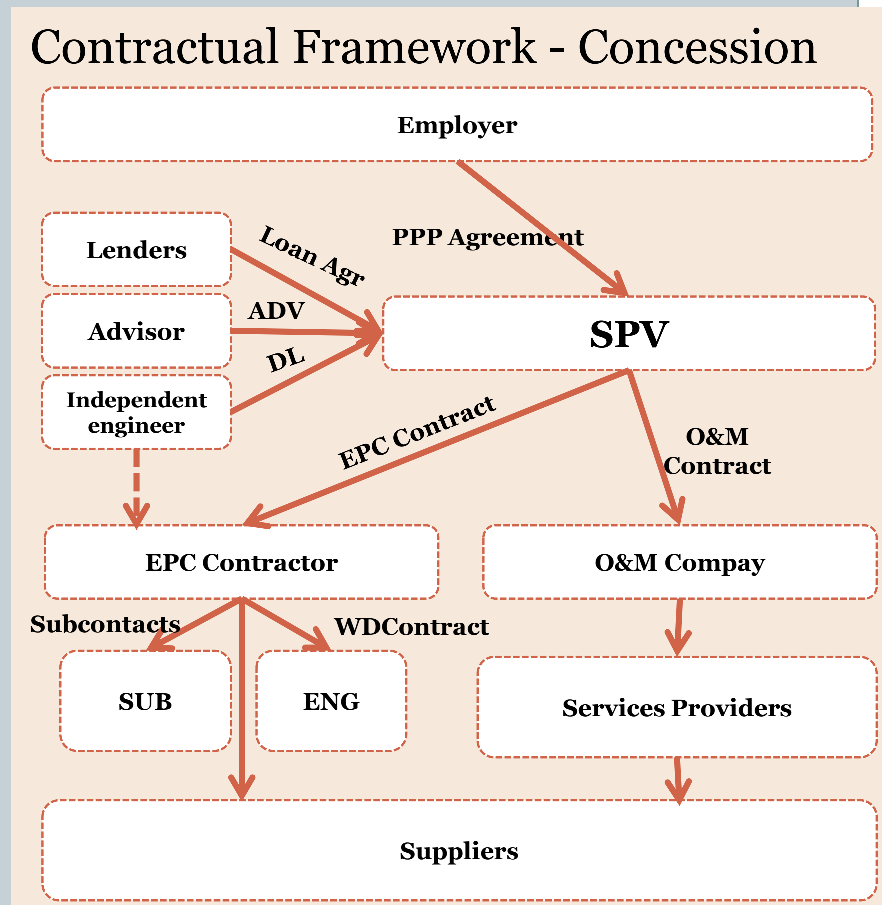
Preliminary Survey

Industry Competitive Position

Big picture of reporting lines of the various players involved in a construction



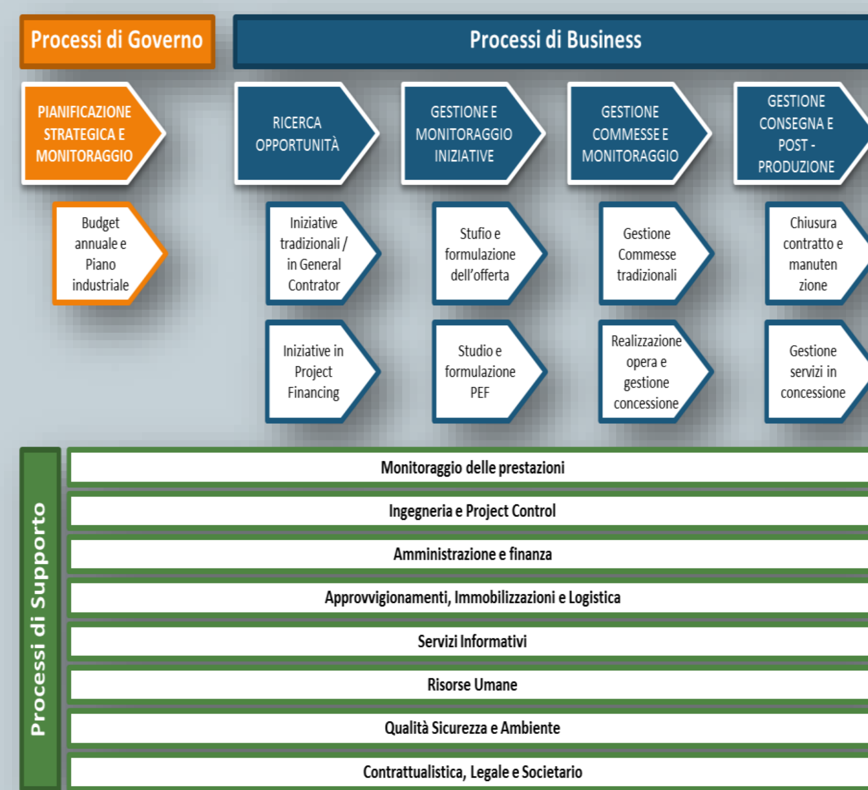


Preliminary Survey

<u>Business Modell Analysis</u>

Hierarchy of business and support processes organized by the company for the creation of value

Figure 1: Porter's Generic Value Chain



Value Proposition

Procurement

Process Objectives
- Efficient allocation of risks
- Synergies to reduce costs
- Quality / timing of deliveries
- Compliance with legislation
- Optimization of financial flows
- Profit / Margin

Critici Success Factor
- Transparency and competitiveness in the purchasing process
- Reliability of Budgeting
- Understanding of customer needs and suppliers
- Synergize supply chain

Key Performance Indicators KPI
- Actual Cost vs Budget cost
- Reducing direct and indirect costs
- SPI / CPI
- Customer Satisfaction
- Reducing claims

Business
- Planning;
- Requirements Planning and purchase request;
- election;
- Award of contract
- Receipt of the goods / service;
- Invoices
- Payments

Supporto
- Management accounting
- General Accounting
- Information Technology
- Industrial services
- Legal services
- Contract Services

External Factors
- Contractual requirements
- Features of the supplier / subcontractor (integrity, professionalism, financial strength);
- Regulatory requirements (eg. Quality, safety, environment)

General Risk
- Availability / quality of supplies
- Contract risk
- Financial risks (and exchange rates)
- Frauds
- Error in record-keeping (required goods - ordered - received)

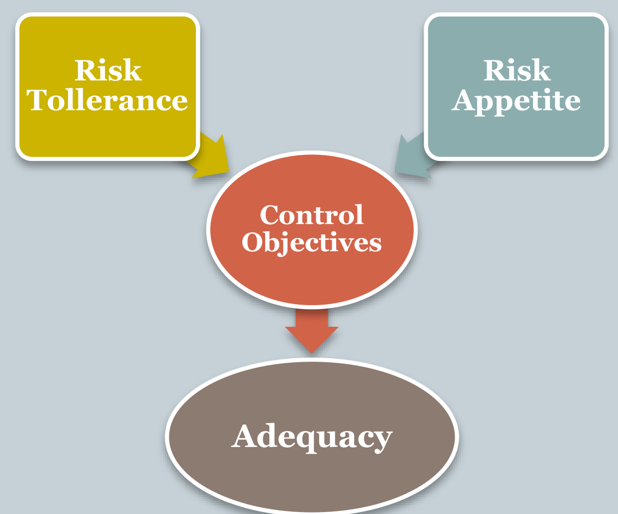
Risk Response
- Programming and project mngt
- Competition
- Segregation of duties
- Monitoring supplies / subcontracting
- Optimal Allocation contractual risks (quality, environment, safety)

Detailed Assessment

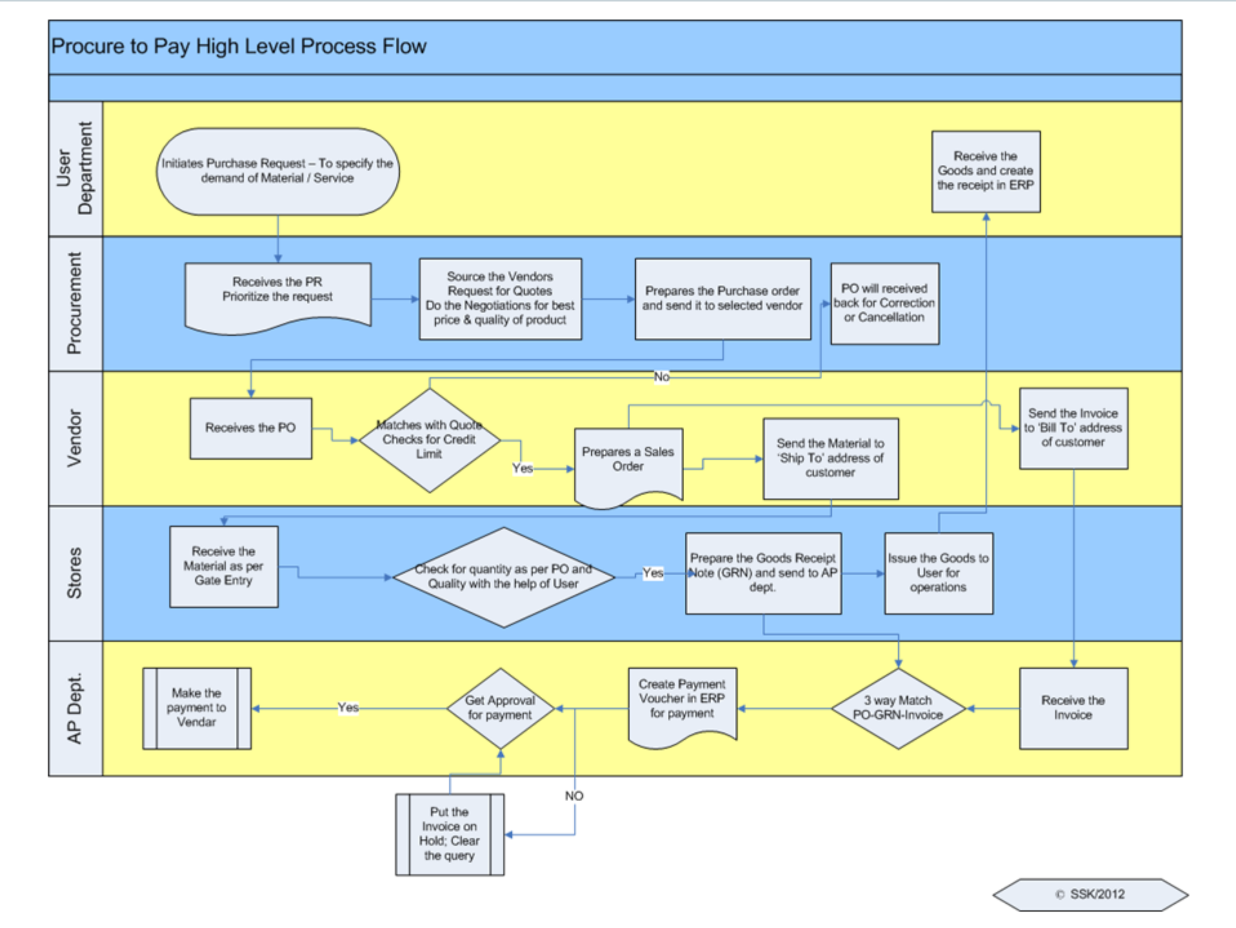
Target	Perform a detailed assessment of process activities, risks and controls
	Identify key officers involved, interrelations, operating procedures, IT tools, specific risks, control layers
	Define the audit strategy
Metodology	Flow-charting
	Risk Assessment
Output	Risk and contol matrix

RISK ANALYSIS

INTERNAL CONTROL ELAVUATION EX ANTE



Flowcharting

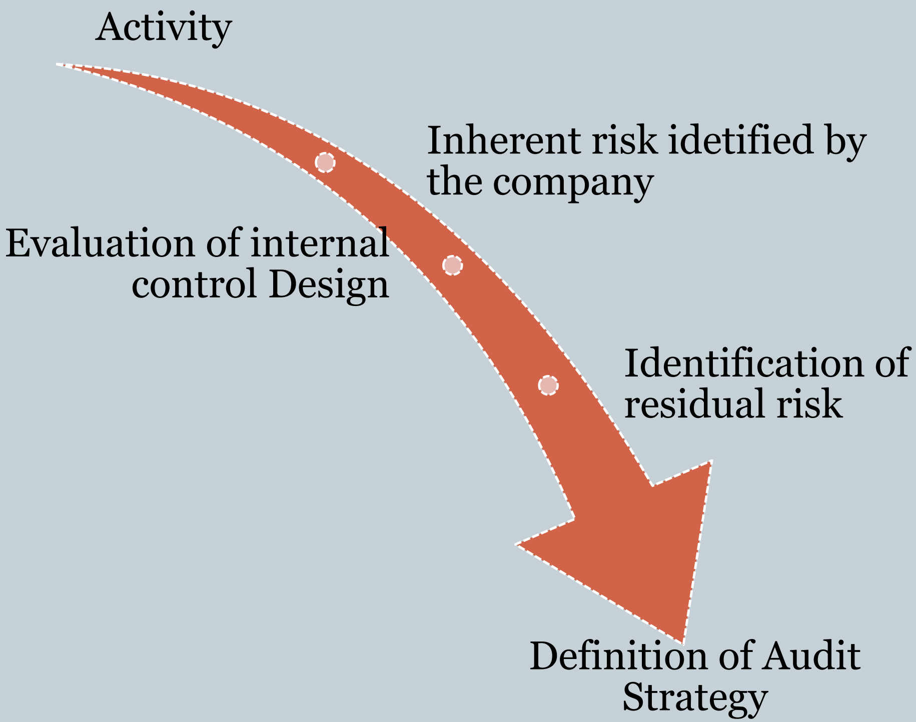


<u>Process Flow</u>

Shows procedural flow of the process and outlines key control points (decision making processes, verification / certification, traceabilityand documentation, IT databases, etc.)

Risk Assessment

Identify Process Activity → Link main inherent risks → Identify Control and evautate residual risk



Assessment: Activities and Responsabilities

Responsible: Responsible to perform the task;
Accountable: Responsible for the results / deliverables of activities
Consulted: Collaborate with the responsible activity in execution;
Informed: It has to be informed;
Verified: Check to ensure criteria compliance (if deliverable or the activity need for verification before approval / authorization)
Signatory: Approve / Authorizes the decision (if deliverable or
when the business need for approval / authorization).

Macro Phase	Activity	Company A								
		CEO	General Manager	Procurement Manager	ADM & FIN MAnager	Legal Department	Wharehouse Manager	Budgeting & Reporting	User Department Responsible	User
Procurement Plan	Define the Procurement Plan									
	Market analisys and vendor list management									
Purchase Request	Define procurement needs									
	Issue the purchase request									
Vendor Selection	Qualification of potential vendors									
	Issue the request of quotation									
	Bid comparision									
	Selection									

FOCUS:
Segregation of Duties & Accountability

Assessment: Activities and Responsabilities

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Macro Phase	**Activity**	**Company A**								
		CEO	**General Manager**	**Procurement Manager**	**ADM & FIN MAnager**	**Legal Department**	**Wharehouse Manager**	**Budgeting & Reporting**	**User Department Responsible**	**User**
Contract Award	Negotiation with preferred vendors									
	Contract preliminary Review									
	Sign of the Contract									
Receipt	Exediting and logistic									
	Receipt of goods and ispections									
	Work valorization									
	Proper servive performance verification (BAP)									
	Goods Receipt Posting									
Invoice Payment	Match invoice with receipt and PO and document the transaction									
	Payment schedule									
	Payment disposal									

Risk and Control Matrix

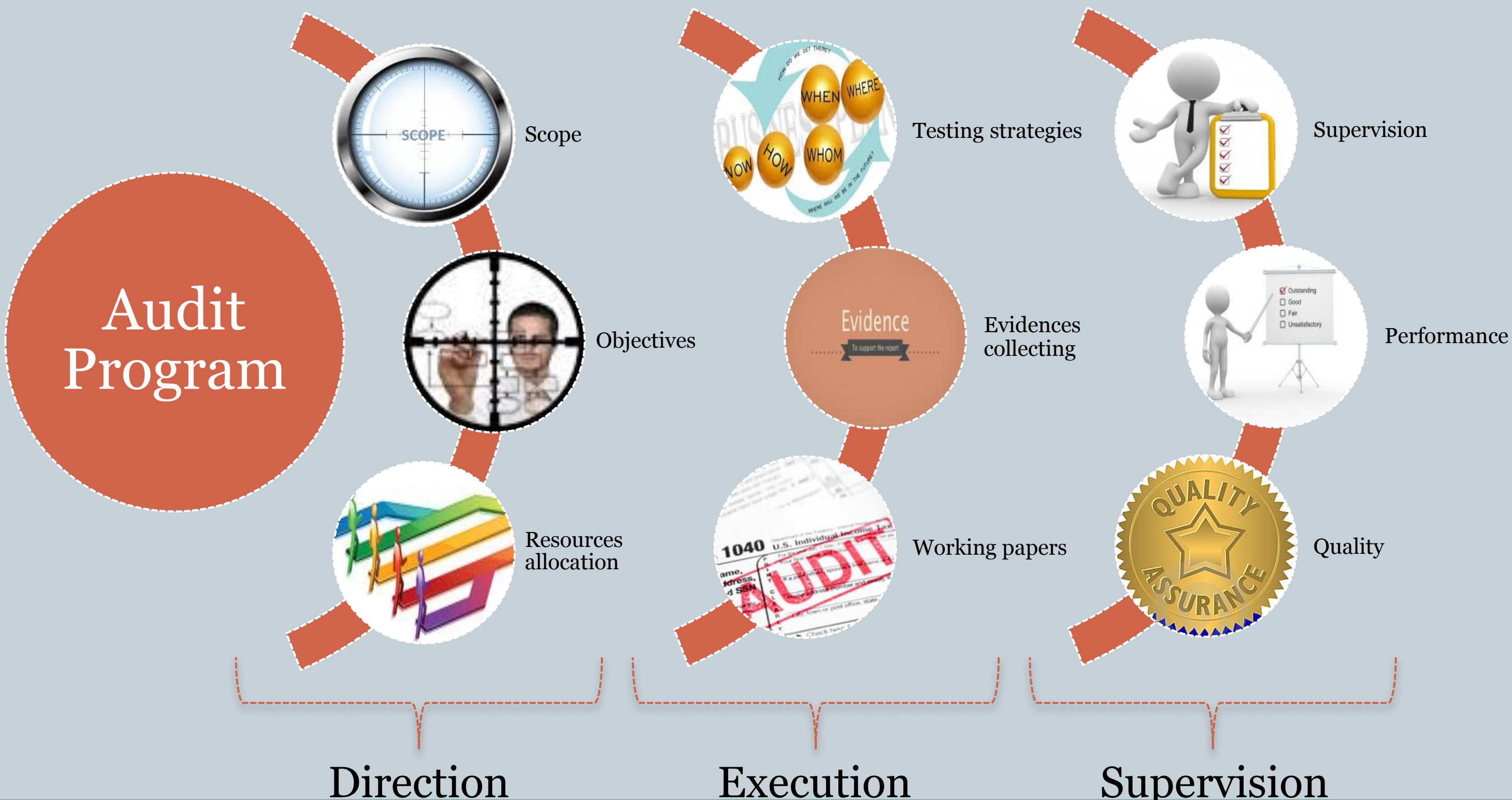
Phase	Activity	Risk	Inherent	Control	Adequacy ex ante	Residual Risk
Procurement Plan	Define the Procurement Plan	Cost increase / Financial Imbalance		Linkage between prorement plan and budget		
	Market analisys and vendor list management	SCM disruption		Long term partnershiop for critical forniture		
Purchase Request	Define procurement needs	Requirement not clear		Predefined merceologia		
	Issue the purchase request	Late requests		PAC monitoring		
Vendor Selection	Qualification of potential vendors	Not reliable vendors		Prequalification of potential vendor		
	Issue the request of quotation	Bid doesn't meet the needs		Standard format for RfQ		
	Bid comparision	Not competitive choice		Predefined selection criteria		
	Selection			Traceability of decision making process		

Risk and Control Matrix

Phase	Activity	Risk	Inherent	Control	Adequacy ex ante	Residual Risk
Contract Award	Negotiation with preferred vendors	Conflict of interests		Bid Tab Approval Process		
	Contract preliminary Review	Claim		Interdepartmental review		
	Sign of the Contract	Risk not properly allocated		Contrat standard		
Receipt	Exediting and logistic	Late delivery		Expediting monitoring		
	Receipt of goods and ispections	Not conformity		Inspection and verification		
	Work valorization	Cost increase / extra costs		Work progress analysis and milestone variances monitoring		
	Proper servive performance verification (BAP)	Fictitious indirect procurement activities		Deliverable approval		
	Goods Receipt Posting	Duplicate posting		Automatic EPR System Control		
Invoice Payment	Match invoice with receipt and PO and document the transaction	Duplicate invoices		Automatic EPR System Control		
	Payment schedule	Invoice without PO		Block of not linked invoices		
	Payment disposal	False, Inflated or Duplicate Invoices, Fictitious Contractor		Vendor database management		
		Duplicate payments		Financial traceability		

Performance Standards
2240 – Engagement Work Program

*Internal auditors must **develop** and **document** work programs that achieve the engagement objectives.*



Audit Program: Audit Strategy

Audit activities should be focused on the significant inherent risks area associated to high level controls

Phase	Risk	AUDIT PROCEDURE	Audit Strategegu
Procurement Plan	Cost increase / Financial Imbalance	Match Procurement plan with Budget	➢ Auditing Analytical Procure
	SCM disruption	Verify minimum and safety stocks optimization and monitoring. Check inventories monitoring policies	➢ Inrerview ➢ Auditing Analytical Procure
Purchase Request	Late request	Check procurment timing and identify any process inefficiencies	➢ Walkthrough tests
		Verify compliance with the internal authorization PR process	➢ Data analytics
Selection	Not competitive choice	Check: - the presence of the approved purchase request; - The sending of the request for quotation to multiple suppliers; - The existence of the tabulation of bids approved by the immediate superior - The presence of selected provided the lists of qualified suppliers	➢ Data analytics ➢ Walkthrough tests

Definizione dell'Audit Program (segue)

Phase	Risk	AUDIT PROCEDURE	Audit Strategu
Contract Award	Claim	Check the utilization of contractual format including: • technical requirements and millestones; • requirements of quality, safety, environment; • clauses 231 • Penalty / force majeure / assicuzazioni etc ..	➢ Interview ➢ Sample Analysis
	Conflict of inerest	Check the PO matches request of purchase, RFQ, offer received and that there are the levels of authorization required	➢ Data analytics ➢ Walkthrough tests
Ricezione del bene / prestazione	Late delivery	Check the timing of processing of shipments and identify any process inefficiencies	➢ Auditing Analytical Procure
	Not conformity	Match DTT with transport documents, order and PR	➢ Data analytics ➢ Sample Analysis
	Fictitious indirect procurement activities	For all the consulting services, verify the existence of the attestation of successful performance	➢ Data analytics ➢ Sample Analysis
Pagamento del fornitore	Invoice without PO	Ensure the traceability of all documentation and flow of electronic transactions to support payment of the invoice	➢ Walkthrough tests
	False, Inflated or Duplicate Invoices, Fictitious Contractor	Check master data vs payment data	➢ Data analytics
	Duplicate payments	Check the matching of invoices paid and recorded in the general ledger with payments arising from bank transactions	➢ Data analytics

Performance Standards

2300 – Performing the Engagement

*Internal auditors must **identify, analyze, evaluate, and document sufficient information** to achieve the engagement's objectives.*

Identifying Information

- Sufficient
- Reliable
- Relevant
- Useful

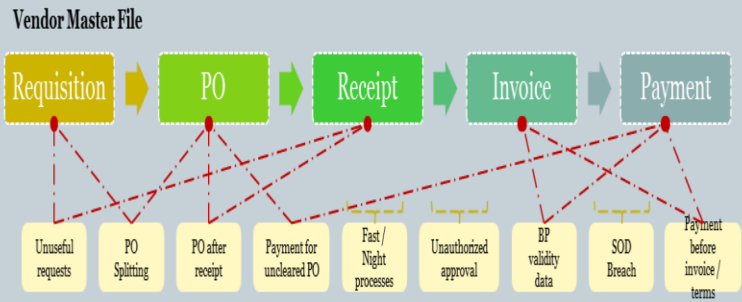
Analysis and Evaluation

- Data Analytics & Continuous Auditing
- Detailed testin and Walthrough
- Analytical procedures
- Root cause analysis

Documenting Information

Relevant information to support the conclusions and engagement results

Data Analytics Red Flags

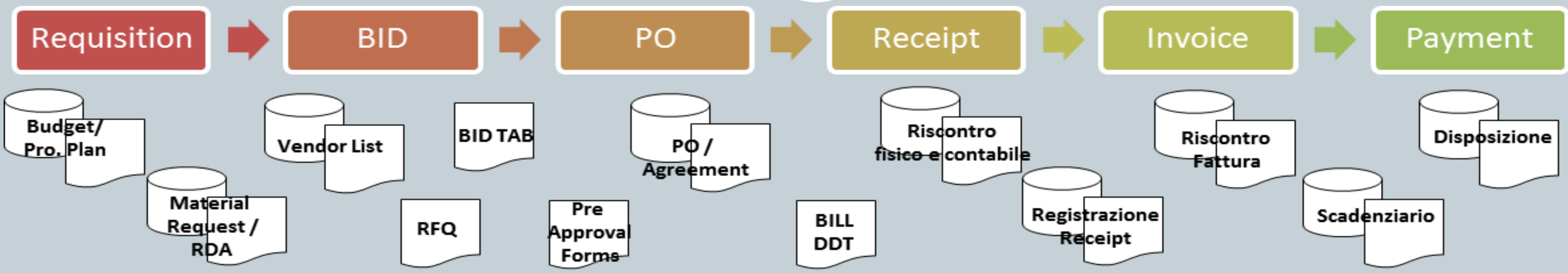


Data analysis as used by internal auditors is the process of identifying, gathering, validating, analyzing, and interpreting various forms of data within an organization to further the purpose and mission of internal auditing throughout enabling technologies such us CAAT

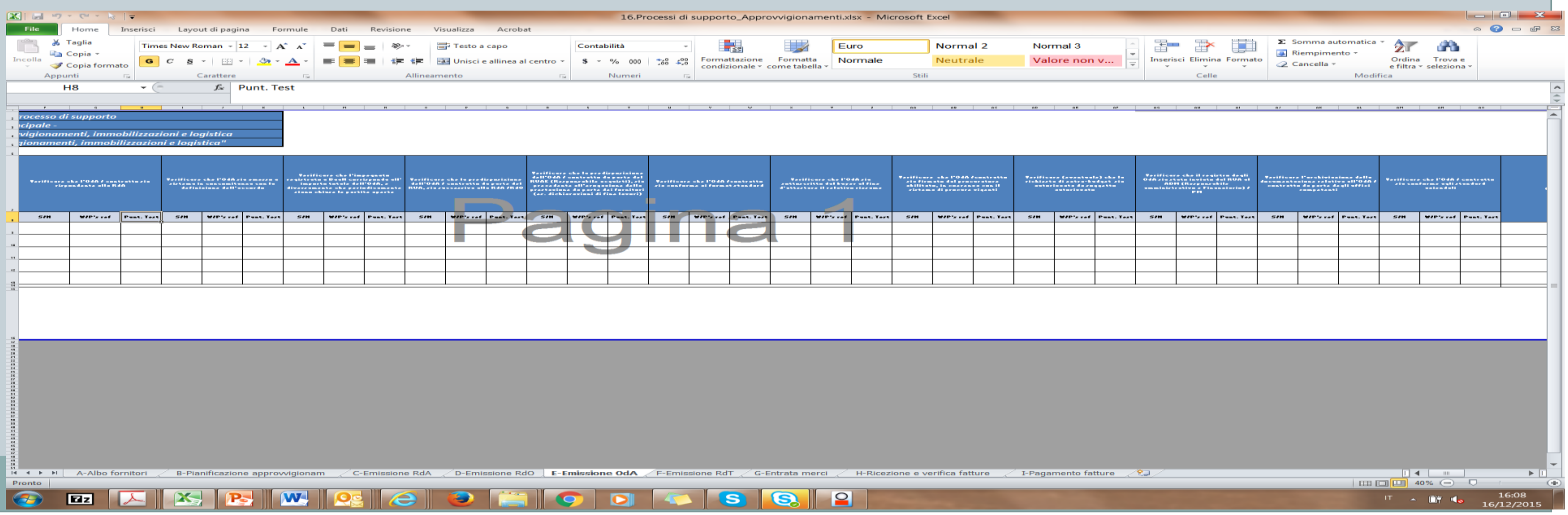
GTAG® 16 Data Analysis Technologies

Area	Control	Data Analytics
Purchasing of goods	Application will not allow a duplicate payment to be processed.	Obtain purchase order data Validate that no duplicate payments (same vendor/same account) were processed.
	The person who creates the PO can't release/approve the same PO.	Obtain a list of all POs created (by originator) Obtain a list of all POs released or approved Determine if any inappropriate segregation of duties (SOD) existed.
Receiving of goods	All goods received (GR) are validated against PO.	Obtain a list of all GR and all POs placed Validate that quantities are the same.
	The person who created the PO can't process any goods that are received.	Obtain a list of who signed for the GR (processor) Obtain a list of who created the PO Determine if any inappropriate SODs existed.
Invoicing	PO should be created before supplier invoice is received.	Compare PO dates against invoice dates and make sure there are no POs dated after invoices dates.
	Amount on PO should agree with amount on invoice.	Compare the PO amount against the invoice amount Validate that there are no differences.
	Segregation of duties (SOD).	Obtain a list of who has processed invoices and who created the PO Determine if any inappropriate SODs existed.
Payment	Application should not allow duplicate payments.	Obtain a list of all payments that have been made to vendors in the last 12 months Determine if duplicate payments have been made, for example: • Same vendor ID and amount but different invoice number. • Same vendor ID and invoice number but different amounts. • Different vendor ID with same bank account detail.
	Segregation of duties (SOD).	Obtain a list of who has processed payment and of who created the PO Determine if any inappropriate SODs existed.
Updating vendor records and adding new vendor files	Ensure that duties are properly segregated to guarantee appropriate control.	Obtain the procurement end-user list (users that have access to the procurement application and the functions that each user has) Determine what functions are conflicting and create a report that identifies those users.
	Audit trail that documents what detail was changed when and by what user.	Obtain the audit trails that contain the details of changes that were made to vendor records Determine if only authorized people made changes Identify possible trends of those who are making changes the most.
	Identify key fields (e.g. bank account detail that should be monitored through management sign-off).	Obtain a list of staff bank accounts with direct deposit Compare account information with the bank detail that was updated on the vendor record
Sufficient application controls to ensure accurate input, processing, and output	1. Valid code test. 2. Check digit. 3. Field check. 4. Limit test. 5. Reasonableness check. 6. Sequence check. 7. Batch control totals.	1. Obtain a monthly download of program code within the procurement application. Determine if any changes were made to the code through data analysis. 2. Obtain the standing data of vendors. Validate that the Income Tax number captured is the correct length. 3. Obtain the standing data of vendors. Validate that only numerical values are captured in the bank account and phone number fields. 4. Obtain a list of all procurements that were made in a month. Validate that all payments above a certain amount (e.g., US $50,000) were authorized by the appropriate user. 5. Obtain a list of all procurements made in a month. Create a trend analysis, per vendor or per procurement type, to identify transactions out of the ordinary.
Value adding services to organizational users	N/A	1. Total dollars spent. 2. Average transaction amount. 3. Transactions per vendor. 4. Dollars spent per vendor. 5. Sort transactions by vendor or commodity. 6. Trend analysis (e.g., seasonal products). 7. Budget vs. actual 8. Age analysis (e.g. GR vs. invoice date)

Walkthrough tests



Analysis of the actual occurrence of the transaction and implementation of control by collecting evidence



Root cause analysis

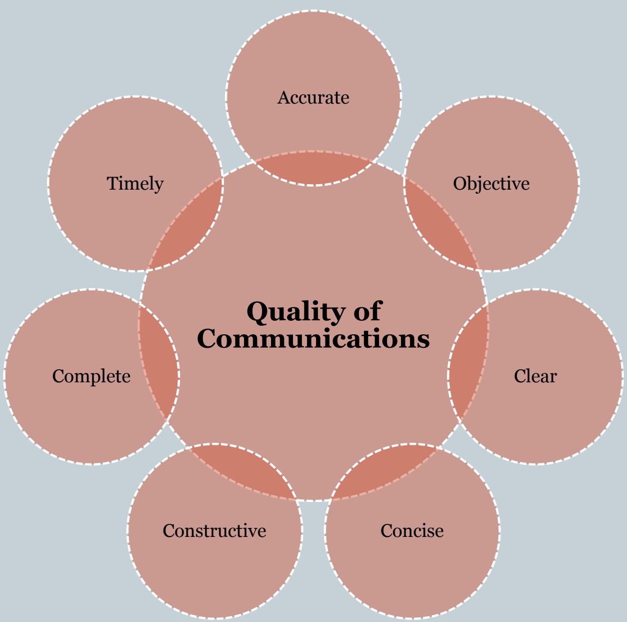
1. **Define the problem/issue**
2. **Gather and classify data**
3. **Ask «5 Why?»**
4. **Identify casual factor e root causes**
5. **Promote solutions**

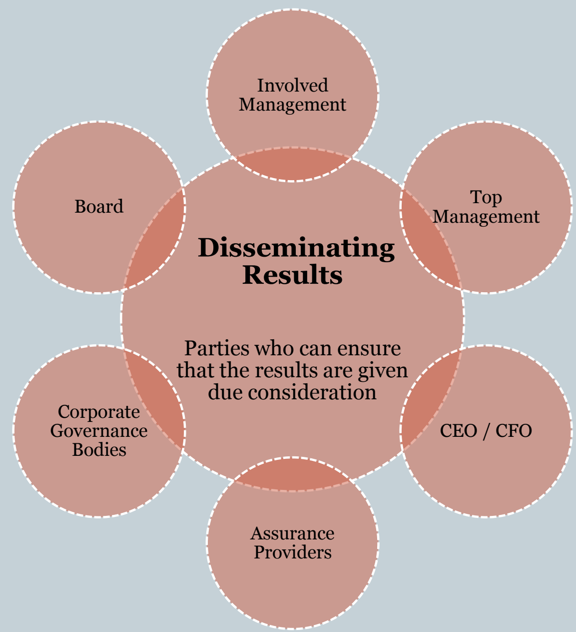
Performance Standards
2400 – Communicating Results

Internal auditors ***must communicate*** *the results of engagements.*

Observations and recommendations are based on the following attributes:

- ✓ **Criteria**: The standards, measures, or expectations used in making an evaluation and/or verification TO BE
- ✓ **Condition**: The factual evidence that the internal auditor found in the course of the examination AS IS
- ✓ **Cause**: The reason for the difference between expected and actual conditions.
- ✓ **Effect**: The risk or exposure the organization and/or others encounter because of the gaps (the impact of the difference)
- ✓ **Recommendations**: based on the cause





Observations and Recommendations

Improper allocation of responsibilities

Criteria
Segregation of Duties

Condition:
Research and selection of suppliers are managed by End Users

Cause:
Lack of training on the procedures and failure to automate the purchasing process

Risk:
Conflict of interest / low Competition/ Fraud

Recommendations: communicate procedures / Define automatic control for processing orders / invoices / payments (access criteria)

Delay in delivering With consequent Business interruption

Criteria
Work Program

Condition:
Goods not available

Cause:
Lead time in processing PR

Risk:
Penalties

Recommendations: Link the procurement plan to work / esimate standard timeframe for processing PR and shipments