

Do the internal controls in your year end-to-end payment fulfill the stringent requirements as defined by Sarbanes Oxley?



The Sarbanes Oxley Act is a very complex, far-reaching piece of legislation. The primary objectives of the act are to provide greater transparency to investors, amplify the objectivity and culpability of the external auditors, and ensure internal controls are sufficiently robust to eliminate financial fiascos such as Enron, WorldCom & Tyco. For most corporate financial staff, the third aspect by far will create the largest workload, and generate the most significant impact on their operations.

In evaluating internal disclosure controls, there is no greater risk area than in the end-to-end payment process. For large organizations, external spend for goods & services dwarfs any internal spend via payroll. On average, external spend consumes \$0.50-\$0.60 per revenue dollar. External spend is a cross-functional process that involves the business unit making the purchase, the receiving department, purchasing staff, accounts payable, and multiple contact points within the supplier's organization. With numerous hand-offs in the process, and a supplier base that may number in the tens of thousands, it is a process that holds significant financial risk. Add to this equation numerous operating locations and thousands of employees, and you can see that many things can go wrong. Sarbanes Oxley demands that your company be proactive in preventing errors.

To add teeth to the enforcement of this legislation, Sarbanes Oxley mandates that executive officers have reviewed the issued financial statements, the statements do not contain any material errors or omissions, and that the financial statements present fairly the financial condition and results of operations for the company. This is contained in Section 302, Corporate Responsibility for Financial Reports. Relative to internal control, Sarbanes Oxley requires that signing officers:

- Are responsible for establishing & maintaining internal controls;
- Designed the controls to flag all material situations during the reporting period;
- Have tested the internal controls for effectiveness within 90 days prior to the financial statements issued; and,
- Have presented in the financial statements their conclusions regarding internal controls.

These are very bold statements that will cascade responsibility throughout a company's organization. In validating these internal controls, the logical first step is documenting the control processes in place, highlighting significant risks, and ensuring that these risks are properly mitigated. • Bypass Procurement – This is the risk that purchases of needed goods & services completely circumvent the procurement function. Since procurement staff represent the experts in acquiring & negotiating the purchase of

goods & services, how much money is lost by not engaging procurement in a disciplined acquisition process?

Documenting Processes & Risks

We recommend creating a process flowchart to help capture the various functional departments that participate in the end-to-end process. The process of documenting the process often identifies well-intended steps that over time have ceased to be effective. In committing the process to a flowchart, you will need to address the process differences relative to purchase orders, signature authorization, and whether you are buying goods versus services. Your process may have unique elements corresponding to practices within your industry. In documenting these processes, be alert to specific steps that are part of the theoretical process, but are routinely bypassed or circumvented.

Once the process is documented, a high level of skepticism is needed to determine "What can go wrong in this process?". Through our audit work, we have found numerous risks that exist across any end-to-end payment process. We have broken these into 3 major areas:

- **Bypass Procurement** – This is the risk that purchases of needed goods & services completely circumvent the procurement function. Since procurement staff represent the experts in acquiring & negotiating the purchase of goods & services, how much money is lost by not engaging procurement in a disciplined acquisition process?
- **Contract/PO Creation** – In creating the contract or purchase order, there are risks in engaging qualified suppliers, misaligning of interests between vendor & supplier, unenforceable contract structure, the competitiveness of the contract versus market conditions, and the communication of the relevant terms to those entrusted with enforcing the agreement. What is the financial cost associated with control weaknesses in the structuring or communication of contract terms?
- **Invoice Settlement** – In the payment of a submitted invoice, errors may happen relative to pricing, payment terms, sales tax, freight, duplicate payments, missed rebates, delayed updates to pricing catalogs, and exceeding proper approval guidelines. How much profit is forgone due to vendors billing your company incorrectly, or process errors resulting in overpayments?

Mitigating Risk

Once the financial risks & exposures are identified, there are a series of questions that must be answered to implement cost effective internal controls. Here are a few examples:

- What procedures & controls have been implemented to serve as a safety net when these risks inevitably materialize?
- How is your financial staff ensuring that these risks for error are being mitigated?
- Are the controls implemented preventive or reactive in nature?

- What about the timeliness of these controls?

With Sarbanes Oxley, the clear direction is one of real-time reporting, not days, weeks or months after the transaction. In the end-to-end payment process, real-time disclosure controls take on particular significance. For anyone who has inadvertently disbursed money to a vendor, and has been unable to recover those funds, it becomes clear that the most cost effective option is to prevent payment errors. How can you move from where you are today to a real-time model of reporting?

The answer lies in business intelligence applications that serve as a front-end to your transaction processing and other relevant systems. Many companies use the terms "dashboards" or "cockpits" to describe tools that capture relevant operating metrics from various sources to present a cohesive, real-time picture of operating metrics and internal controls. These dashboards incorporate "alerts" to sift through masses of data to flag pre-defined exceptions that require immediate management attention. This is true management by exception.

No longer will it be acceptable to produce operating metrics fifteen days after the end of the month. The biggest challenge is defining that handful of meaningful metrics that drive your business results, and the business alerts that require immediate action by management to correct. For the end-to-end payment process, these would include cost metrics, productivity measures, control metrics regarding error ratios & overpayments, cash flow indicators and customer service metrics. With these in hand, you can confidently live up to the spirit and letter of the law regarding Sarbanes Oxley.