Internal Audit of Procure to Pay Process
&
Sales / Service Income

CA Kalpesh Panchal

Webinar on internal audit for CA students organised by WICASA of WIRC of ICAI
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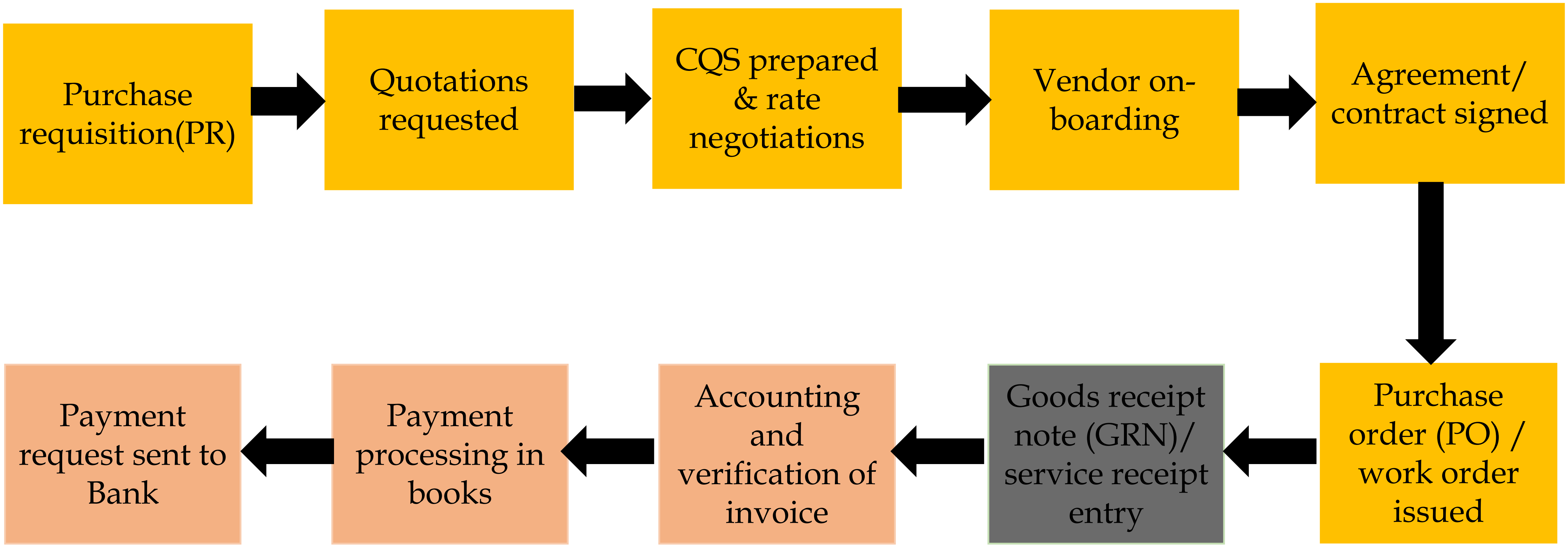
Internal Audit of Procure to Pay Process

Contents

1. Procurement - Introduction & basics

- What is Procurement?
- Procurement v/s Purchasing
- Significance of procurement area – from client and auditor's perspective
- Common myths when we hear "Procurement audit/ review"
- Capex procurement review is not covered extensively in this training session

2. The Procurement cycle



	User department, Purchase team & Procurement team involved
	Stores & user department involved
	Finance team involved

3. Preliminary work and process understanding

- Understanding client business through information available in public domain.
- Reading previous internal audit report & review of previous audit working papers.
- Reading SOPs, policies and internal guidelines specific to client.
- <u>Preliminary process understanding. It helps us in identifying:</u>
    - ➢ Gaps/ issues in the procurement process,
    - ➢ Key stakeholders involved,
    - ➢ Absence of controls like segregation of duty,
    - ➢ Possible avenues for introduction of automation.
- Understand ERP used by client & work flow defined within ERP.

4. Data gathering

- SOP, relevant policies, ISO manual, management guidelines and authority matrix
- Organization chart
- List of agreements entered with the vendors/rate contracts
- Vendor master & preferred vendor list
- Purchase requisition register
- Purchase register
- PR, PO, GRN, GR/IR listing
- General ledger dump for all expense ledgers
- Payment register & vendor payment dump
- Bank book
- MIS reports, etc.

5. Sampling (1/3)

Broad areas where sampling is carried out:

- CQS review
- PR & PO review
- Invoice review
- New vendor registration review
- Contract/ agreement review
- Payment review

5. Sampling (2/3)

<u>Few aspects that can be considered while selecting samples:</u>

- New product or service acquired
- Purchases from new vendors
- Purchases from one time vendors
- Same/ similar products purchased from different vendors
- Same items purchased from same vendor at different rates
- Inter-state purchases
- Purchases made at year end and purchases in cash, etc.

5. Sampling (3/3)

Common sampling techniques that can be adopted:

Techniques	Remarks
80-20 Principle	• Focus should be to cover **80%** of population in terms of **value** which comprise **20% of total transactions**.
Relative size factor (RSF)	• RSF is determined based on highest & second highest values in data set. • Outliers indicate potential fraudulent/ irregular transactions
Stratified/ Block Sampling	• Classify the total transactions in small groups (e.g. based on nature of purchases) • Select samples from each such subgroup for review
Benfords law	• This technique provides the expected errors in a data set. • It can be used for identifying cases of splitting of purchase order , etc.

Note:

- Top 10 high-value transactions should always be included in our sample.
- Softwares like IDEA can also be used for Stratified, RSF, Benfords law & random sampling.

6. PR, PO and GRN review (1/3)

Common checks done:

Area	Particulars	Remarks
PR and PO	**Review of PR and PO dump:** • Open PR/PO (*) • Process for monitoring and reporting open PR/PO items • PR/PO pending for approval • Splitting of line items for PO creation • Same items purchased from different vendors at different rate • Same items purchased from same vendor but at different rate • PO created for one-time vendors	E
	Routing of expenses through PO	
	PR/PO created after invoice/goods receipt, etc.	
	Review of system based approvals for PR/PO (including threshold based approvals)	S
	Comparison of PR/PO values with budgets & related controls	
	Review of PO for consistency, terms and declarations obtained from vendors	

(*) Review of open PR/PO is done for data as on a given date. Hence, it may also include instances beyond our audit period.

S Checks done on a sample basis E Checks usually done on entire data for the audit period P Process understanding & discussion with client

6. PR, PO and GRN review (2/3)

Common checks done (continued):

Area	Particulars	Remarks
GRN (*)	**Controls over receipt of goods:** • Person responsible for receiving and checking goods • Process followed & records maintained for goods received after re-work/ repairs • Registers/ gate records and other documents maintained • Checking of goods received register with PO/ invoice	P S
	Controls over GRN booking	
	Comparison of lorry receipts/ challans with GRN date	S
	GR/IR entries: • Procedure followed for booking GR/IR entries • Controls over review/ reporting of open GR/IR items at end of year/ period	P E
PO v/s GRN	Comparison of PO date and GRN date	S
	Comparison of PO quantity and GRN quantity	
	Controls over goods received without valid PO	P

(*) In case of services, GRN would not be there. In such cases, we can check service acceptance notes, progress statements, milestone achievement statements, etc.

S Checks done on a sample basis   E Checks usually done on entire data for the audit period   P Process understanding & discussion with client

6. PR, PO and GRN review (3/3)

Common observations noted:

Lack of monitoring of Open PR/PO items	Goods delivered but yet to be invoiced or booked	Absence of maker checker controls for PR/PO creation	Splitting of purchase bills to avoid PO creation process/ by-passing approval of concerned authority
Expenses not routed through PO	Back dated/ Post facto creation of PO without adequate approvals	No formal guideline to define nature of expenses where PO is not required	Significant delays between GRN booking date and delivery challan date
No process to monitor GR/IR entries on a periodic basis	PR/PO release strategy not defined in system (manual process followed)	Standard clauses w.r.t GST compliance, MSME declaration, etc. not included in PO	Exceptional approvals not taken for PO values exceeding approved budgets

7. Review of quotations and CQS (1/2)

Common checks done:

S P

- Compliance with SOP/ Procurement policy (especially with regards to minimum quotation requirement and documentation for exceptional cases)
- Quotations should be <u>comparable</u> (e.g. received during same time period) and <u>competitive</u> (e.g. received from distinct/ unrelated parties)
- Controls over preparation, review and approval of CQS (including exception lists) and vendor negotiations
- Factors such as credit terms, interest rates, GST, MSME status of vendors etc. are duly considered while preparation of CQS

S	Checks done on a sample basis	E	Checks usually done on entire data for the audit period	P	Process understanding & discussion with client

7. Review of quotations and CQS (2/2)

Common observations noted:

- Old/ previously issued vendor quotes used for new procurements
- Quotation not invited / justification for not inviting quotations not documented
- Absence of maker checker system at time of seeking quotations/ evaluation
- Editable/ unsigned quotations used for evaluation
- No documentation available for negotiations made with vendors
- No documentation available for vendor capacity assessments/ site visits conducted during evaluations

8. Review of invoice, supportings, etc. (1/2)

Common checks done:

Particulars	Remarks
Comparison of invoice with underlying PO (terms, value, etc.)	S
Comparison of GST and other statutory details as per invoice and vendor KYC documents	
Invoice approved as per SOP	
Debit notes/ credit notes issued	
Supportings required as per PO/Agreement & statutory requirements duly attached	
Comparison of invoice date, GRN date, booking date, etc.	E
Review of vendor debit balances	
System and related controls followed at time of invoice booking	P S
Procedure/ checklist in place for checking invoices, etc.	
Controls over TDS & GST input availment at time of invoice booking	

S Checks done on a sample basis E Checks usually done on entire data for the audit period P Process understanding & discussion with client

8. Review of invoice, supportings, etc. (2/2)

Common observations noted:

- Delay in invoice booking
- Back-dated booking of invoices
- Goods received but invoice booking not done (open GR/IR items)
- GST details not mentioned in the invoice/ incorrect details mentioned
- Mismatch in bank details as per invoice and KYC documents
- No maker checker system followed for invoice booking
- Deductions/ retentions not made in case of absence of supporting documents
- Editable/ unsigned invoices sent by vendor
- Miscellaneous/ unsupported charges claimed in invoice over and above PO value
- Non-compliance with labor laws by outsourced manpower suppliers
- Old vendor debit balances outstanding for substantial period

8. Review of payment to vendors (1/2)

Common checks done:

S P

- System and related controls over payment entries and subsequent processing
- Procedure followed for monitoring overdue balances through system, including payments for MSME vendors
- Comparison of payment with terms as per agreement/ PO
- Comparison of details used at time of payment processing (e.g. bank account) with underlying data in vendor master
- Controls over retention of amounts as per terms of contract, GST withheld, etc.
- Payment made in compliance with statutory requirement (e.g. TDS, etc.)
- Payment checklists, etc. prepared prior to processing payments

S	Checks done on a sample basis	E	Checks usually done on entire data for the audit period	P	Process understanding & discussion with client

8. Review of payment to vendors (2/2)

Common observations noted:

- Maker checker system not followed/ available for payment processing
- Splitting up of payments to avoid approval thresholds
- Bank payment entries passed in books after processing
- Mismatch in bank account details as per payment records and vendor master
- No process for monitoring overdue balances to MSME vendors
- Payment not made as per PO/ Agreement terms
- Discounts/ rebates (as per PO/ agreement) not factored at time of processing payments.
- GST component not withheld for defaulting vendors

9. Vendor management (1/2)

Common checks done:

Area	Particulars	Remarks
Vendor on-boarding review & evaluation	Documents required as per checklist are obtained from vendors	S
	Comparison of information as per registration documents and vendor master	
	Custodian and accountability for checking vendor registration documents.	P S
	Controls over one-time vendors	
	Controls over ongoing monitoring of vendors (e.g. annual evaluations, etc.)	
Agreement review	Consistency in nature of clauses, payment terms, etc. across similar agreements.	S
	Inclusion of critical clauses such as right to audit, etc. in agreements.	
	Tracker/ control sheets maintained for executed as well as ongoing agreements	P S
Vendor master	Adequacy of information captured in vendor master (especially MSME related, GST, etc.)	P S
	Controls over vendor master creation and updates (especially maker checker system and approval workflow)	

S Checks done on a sample basis   E Checks usually done on entire data for the audit period   P Process understanding & discussion with client

9. Vendor management (2/2)

Common observations noted:

Complete set of vendor registration documents not obtained from vendors	Mismatch in info as per registration documents and vendor master	Right to audit clauses not included in contracts for outsourced service providers	No formal process for monitoring contracts nearing expiry/ renewal date
Absence of vendor evaluations on a yearly/ periodic basis	Inactive vendor codes not blocked/deleted in system	Multiple vendor codes created for same vendor	Incorrect PAN/ GST number captured in vendor master
No field available in vendor master for capturing MSME status of vendors/ bank account details	No maker checker system in place for updating vendor master	No formal guidelines for updating vendor master	No log available for changes made to vendor master

10. Segregation of duties

<u>Following factors should be considered while checking SOD controls:</u>

- Nature of client & sector in which they operate
- ERP/ accounting system used, including configurations available in the system
- Volume and nature of purchases made/ expenses incurred
- Maker checker controls deployed (in cases where there are no SOD specific controls)

11. Statutory compliances

Verification of documentary proofs for below compliances:

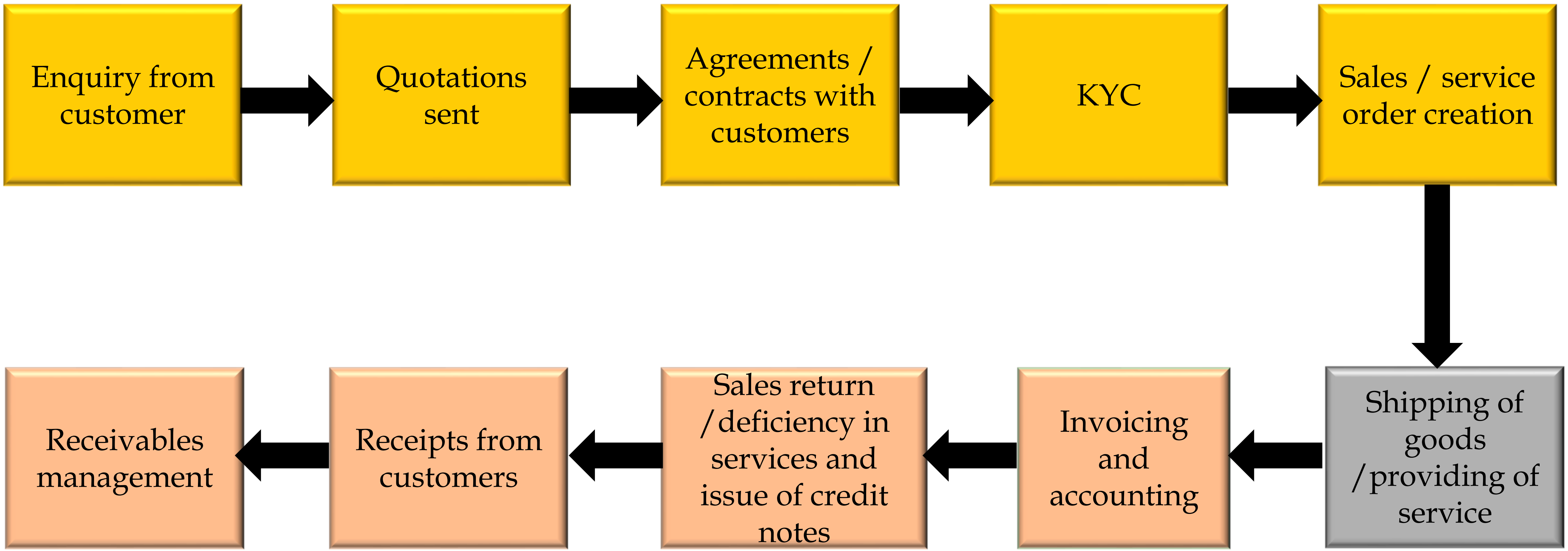
- Filing of GST returns on the goods/services purchased from registered or un-registered vendors
- Payment of custom duty and custom clearance of imported material
- Provisions of Sec 188 of Companies Act 2013 in case of purchase from related parties
- Deduction and payment of TDS on purchase of goods/services
- Pricing at fair value for purchases made from sec 40A(2)(b) parties as per the Income Tax Act 1961
- Government guidelines and other compliances related to purchases from MSME vendors

Internal audit of Sales / Service Income

Contents

Revenue Cycle
Customer Management
Order Management
Invoicing
Cash Receipts
Credit and Debt Collections
Analysis and Reporting

1. Revenue cycle



	Sales department & Marketing team involved
	Stores department / operational department involved
	Accounts / Finance team involved

2. Preliminary work

Reading SOPs, revenue recognition policies, discount policies and internal guidelines specific to client

Holding discussions with client regarding their business, major products, services they offer and their major customers

Understanding products and services offered by client by visiting the client's website

Reading previous internal audit reports & review of previous audit working papers

Understand ERP used by client & work flow defined within ERP

3. Data gathering

SOP, relevant policies, ISO manual, management guidelines and authority matrix	Organization chart	Customer enquiry listing	Sales / service orders listing and goods issue register
Price list / rate masters	List of agreements entered with the customers / rate contracts	Sales register	Product wise sales summary
Customer master	Ageing report of debtor balances as on date	General ledger extract for all sales and sales related ledgers	MIS reports, GST records, etc.

4. Enquiries & quotations to customers (1/2)

Common checks done:

Area	Common Checks	Procedure
Enquiry	Process understanding from client of how enquiries are received by personnel and captured in system	Discussion with process owners
	Check whether all enquiries are captured in system	Review the centralized email ID and whether serial / tracking numbers are assigned to each enquiries, etc.
	Any delays in capturing of enquiries	Obtain e-mail communications of samples and check whether enquiries are captured timely basis
	Any open enquiries and reasons	Generate open enquiries as on date and enquire reasons
	Any internal monitoring of enquiries	Discussion with process owners and review MIS process (lead conversion analysis, enquiry received, etc.)
	Whether reasons captured for cancelled enquiries	Generate cancelled enquiries list and review the reason for cancellation
Quotations to customer	Any variance between prices quoted and price list / rate master	Compare prices of selected samples with price list / rate master
	Understand approval process followed in case of deviation from price list	Obtain authority matrix (AM) and verify for selected samples
	Quotations approved before sending the quote to the client	Obtain signed/email approvals for the samples selected
	Time lag between date of enquiry from customer and date of quotations sent to customers	Compare date of enquiries with date of quotations sent to customers

4. Enquiries & quotations to customers (2/2)

Common observations noted:

Enquires not compiled in a single database (manual control)	Significant delay in capturing of enquiries in system	No process to review open enquiries	Time lag in sending of quotations
No standard price or rate master maintained	Verbal approvals obtained in case of deviations from price list	No process of lead conversion analysis	No maker-checker control over quoting the customer

5. Sales order & goods issue (1/3)

Common checks done:

Area	Common Checks	Procedure
Sales / Service Order	Check whether the SO's are approved as per the authority matrix - Whether approval process is manual or automated	Review release strategy for samples selected and understand the approval process from the client
	Any mismatch between price set in SO and price list / rate master	Compare prices of products / services with price list / rate master
	Whether appropriate approvals obtained in case of deviation from price list / rate master	Obtain authority matrix (AM) and check approvals over price variance
	Any non-compliance with discount policy	Review discount policy. Also, scrutinize the discount ledger and select samples to verify with the compliance with discount policy
	Any instances of excess credit to customers	Review customer masters and check for credit limit defined for samples selected.
	Any inconsistency between terms of customer PO and SO	Trace price, delivery and payment terms of samples from customer PO against SO for samples selected
	Check whether any time line defined for creating SO	Generate list of SO and compare with customer PO date
	Review of open SOs	Generate the list of Open SO's and enquire for the reasons

5. Sales order & goods issue (2/3)

Common checks done:

Area	Common Checks	Procedure
Goods Issue / Delivery notes	Ensure goods issue note is prepared only after release of SO	Discussion with process owners and comparison of SO date with the good issue date
	Ensure whether a register is maintained stating the quantity of goods going out from the factory gate along with the date and time	Review gate register and details of inventory movement captured in it
	Check whether process of quality inspection is conducted	Check whether goods are issued post quality inspection and also check process of quality check is followed as per the internal checklist (if any)
	Check whether dispatch of goods is according to the delivery terms or delivery instructions	Check movement of goods for samples selected
	Any instances of excess goods delivered against SO	Look into whether any tolerance level is defined in system to restrict the same. If no, enquire with the team as to what are the control to prohibit excess delivery

5. Sales order & goods issue (3/3)

Common observations noted:

No maker – checker control in SO	SO release strategy not defined in system (manual process)	Sales order prepared based on verbal communication from customer	Rights to edit / update sales order available to personnel
No process to review open SO	Delay in creation of SO in system	Mismatch between payment terms amongst customer PO and SO	Gaps in SO document numbering
Deviation from credit exposure policy and approvals not documented	Back dated SO created in system	Goods issue note prepared prior to release of SO	Lack of controls at factory gate such as no register maintained or incomplete register

6. Invoicing & credit notes (1/2)

Common checks done:

Area	Common Checks	Procedure
Invoicing / Billing	Compliance with revenue recognition policy	Obtain SOP for revenue recognition and check compliance
	Compliance with Companies Act	Check whether CIN is mentioned on the face of invoice
	Compliance with the CGST Act and Income tax Act	Check whether GSTN is mentioned on the face of invoice. Also check whether the provisions of e-invoicing are followed. In case of invoice above Rs.2,00,000 ensure that customers PAN number is mentioned on the invoice
	Compliance with maker – checker system in invoice preparation and dispatch	Review maker – checker controls for samples selected
	Any mismatch in prices and terms of payment	Trace price & payment terms of samples from SO to invoices for samples selected
	Whether timely billing is happening - Any cases of delay in invoicing of goods delivered /services provided	Goods - Compare the goods issue date with the actual billing date for selected samples Services - Compare billing milestone agreed with customer and actual billing date for selected samples
	Any cases of material issued but billing is pending	Comparison of factory gate register with sales register
	Whether taxes are captured properly	Review tax masters
Credit Notes	Match credit notes to invoices issued	Check approvals of credit notes and obtain reasons
	Whether credit notes pertain to the correct period	Scrutiny of credit notes to confirm it is relating to appropriate financial year
	Any credit notes issued because of deficiency in services provided	Check the service parameters maintained by the company in provision of service and obtain reasons for such deficiencies

6. Invoicing & credit notes (2/2)

Common observations noted:

Delay in billing	Short billing (in case of cost plus entities)	Revenue leakages	Manual control over shipments
No approvals documented for discounts granted	Manual invoice prepared	Missing invoice number in sales register	Diff. in revenue as per operating system and financial system
Need to mention MSME registration details in invoice	Credit notes are not system generated	Services pending to be invoiced	

7. KYC process (1/2)

Common checks done:

Area	Common Checks	Procedure
Customer registration	Understand what is the registration process for a new customer	Discussion with client and walkthrough
	Understand how credit worthiness is evaluated	Review credit assessment forms prepared for new customers
	Understand the process of granting credit period to the customer	Discuss with client & understand the basis of credit period granted. Check whether approvals are obtained for unusual credit periods
	Any non - compliance in KYC registration process	Review whether necessary internal checklists/SOP are filled and documents are collected from the new customer
	Check principle of maker – checker exists in creating new customer code in system i.e. is any critical information like GST/PAN not collected or if any incorrect information is captured	Review maker – checker processes for samples selected. Review customer masters of selected samples to check if all details are properly filled
	Check whether credit limits are defined for customers. If yes, also check for instances where credit exposure exceeds the credit limit defined	Review customer master
	Any duplications in customer master	Review customer master and observe for entire population

7. KYC process (2/2)

Common observations noted:

Duplicate customer codes	Necessary documents not collected and internal checklists not filled for customer registration	Mismatch in information as per registration documents and customer master
No maker checker system in place for updating customer master	Credit limits not defined in customer master	Suggestion to restrict raising of SO if debtor exposure exceeds credit limit defined

8. Collection from customers & debtors review (1/2)

Common checks done:

Area	Common Checks	Procedure
Collection from customers	Understand follow up mechanism of receipt of amount due from customers	Obtain follow-up mail communications with customer for selected samples
	Whether comparison of actual recovery from customer with the expected recovery is done. If yes, check whether deviations from estimated collections are captured in MIS	Check analysis performed by client. In case of short collections, check whether reasons / justification for the same is documented
Debtors review	Any amount of old receivables	Extract ageing of receivables and obtain reasons for old debtor balances
	Whether receipts adjusted against corresponding bills	Review debtor ledgers on test check basis
	Check timely reporting of old outstanding to management	Review MIS and whether actions taken are documented
	Check whether any provision is required to be made	Scrutinize debtor ledgers and discuss with client about possibility of recovery
	Any credit balances of debtors	Generate open customer line items reports and obtain reasons for advances received but goods not dispatched / service not provided
	Whether company has a process of obtaining confirmation of outstanding balances from the customer annually / semi-annually / quarterly	Check customer balance confirmation obtained for samples selected

8. Collection from customers & debtors review (2/2)

Common observations noted:

Old irrecoverable balances to be written off	Approvals not readily available for balances written off	Credit balances of debtors
Receipts are not adjusted against invoices raised	Mismatch between debtors ageing report and general ledger	Debtors ageing manually prepared

9. Statutory compliances

Verification of documentary proofs for below compliances:

Filing of GST returns on the goods/services sold to registered or un-registered parties	Payment of custom duty / GST and custom clearance of export material
Provisions of Sec 188 of Companies Act 2013 in case of sale to related parties	Compliances under MSME Act 2006

10. Customer quality complaints & feedbacks

Common checks done:

Area	Common Checks	Procedure
Complaints from customers	Understand process of capturing complaints from customers	Discussion with process owners and walkthrough
	Enquire as to what actions are taken over the complaints	Review MIS and check whether any action taken report (ATR) is prepared
	Compliance of TAT (Turnaround Time) as per SOP	Check on samples basis time taken to resolve
	Any old open customer complaints	Review complaint register
Feedbacks	Understand process of obtaining feedback from customers (specially in case of service entities)	Discussion with process owners and review on sample basis

11. Key audit considerations in service entity

Focused audit of customer service quality at each stage of customer interaction viz. entering of contract, customer support & customer balance settlement

Assess reputational, customer loss risks and regulatory risks

Review of compliance with internal standards of customer service quality

Using customer satisfaction surveys for measuring the consumer loyalty index

Ways and means of measuring presence of motivation of employees involved in customer service processes

Use of audio and video control tools in customer interaction

Questions