Risks and Measures of Purchasing and Payment Activities in Internal Control System

HAKKI FINDIK
Kırklareli University
Faculty of Economics and Administrative Sciences, Kırklareli, Turkey
hakkifindik@klu.edu.tr

Extensive Summary

Purchasing and payment cycle is a process to begin with the needs for goods or services, and to be completed when the payment was made. The excessiveness of documents used in this cycle, large number of working personnel, different departments’ participation to the cycle makes it open to fault and fraud. The main aim of controls will be held in purchasing and payment cycle is to provide recognition and reporting for the operations in the cycle to be done in an accurate and complete way. In this study, the risks which are emminent to businesses in the cycle of purchasing and payment, analysis of these risks, possible policies to prevent risks, procedures and implemetnation and fault-fraud cases are explored.

As it is highlighted in the independent auditor’s report; preparation of financial statements, fair presentation, responsibility of providing the information that do not contain significant fault and fraud belong to the business management. According to the results of the research, the auditing activity is insufficient in revealing the fraud. Also because of the increasingly complex and thriving nature of the businesses, specific studies for uncovering frauds are needed. Purchasing and payment cycle is carried out with the participation of internal and external community of shared interest. Internal community of shared interest are shareholders, owners, managers and employees. External community of shared interest are investors, customers, governement and service providers. In this cycle; the faults and frauds of both internal and external communities of shared interests can be seen. One of the most important steps to obstruct the faults and frauds is to have an effective internal control system. An affective internal control system is only possible with a good design and application. COSO is constituted from eight components of internal control system which are control environment, risk asssesment, control activities, information and communication, monitoring activities, determination of targets, identification of events and responding to risks. Purchasing and payment cycle is explored by dividing five phaces in our work. These phaces are purchase request, purchase order, receiving, recognition and payment.
Purchase request may come from any department of the business. “Purchase Request Order” must be formed by the authorized person or unit and should be sent to purchasing location. Some of the risks that may occur at this phase listed below:

- Unused goods and service demands,
- Double purchases,
- Inapplicable demands to inventory policy,
- Risks caused by communication problems,
- Acquisitions which do not meet the customer requests,
- Non-updated stock levels,
- The difference of quality and quantity between demand or order.

Purchase requests should be evaluated by the purchasing department. This evaluation must be documented via filling a “Purchase Order Form”. This form should be sent to the vendor, receiving, accounting and payment departments.

Goods or services must be received by a separate department of the business. Receiving process should be documented with a “Receival Report”.

At the end of receiving process, there will be a debt burden. So this process is the breaking point in the cycle. A vital question in this phase is whether the delivery unit should be aware of the required goods’ or services’ features (e.g. quantity, quality, price, function) beforehand. The risk in here is the subjected unit’s careless performing in receiving although they are aware of the features of the goods or services beforehand. There may be problems such as acceptance of irrelevant goods in the absence of information.

Documents such as “Purchase Request Order”, “Purchase Order Form”, “Receival Report” are not required for accounting. Required document for accounting is the bill. In the case of not submitting the bill to the accounting department, there may arise a risk of delays in accounting records. This risk affects directly to the financial reports’ preparation processes.

The last phase of the cycle -debt payment- must be performed with the completion of the other phases. So, it is crucial that processes occurring in the cycle should be transferred to the payments unit.

These five phases of the process must be performed effectively with documentation and accounting, the principle of segregation of duties, authorization, done with independent physical control and reconciliation. The principle of segregation of duties requires different people or unit for each task and it is divided to different units. This principle it is intended to prevent fault and fraud of some individual in a closed cycle. Five phases determined within the framework of the cycle must be fulfilled by different units. Authorization is a specific determination of the responsibility for task. This five phase process should be performed by only authorized personnel. The information, document and work-flow must be provided by only responsible persons in the cycle. Taking measures in the flow of information is especially important when they are handled digitally, the access of unauthorized person or unit should be restricted. Control mechanisms should be available during receipt of
good or services. The activities of the cycle in question should be made independent from each other. In these phases which are integrated to each other, activities should be documented and a unit should not generate an element of pressure on the other. Agreement on certain time intervals should be made with both internal and external counterparts. The unit which will provide payment should do the comparison of the “Purchase Order Form”, “Receival Report” and “Vendor Bill”, and then follow through the payment.

As a result, the potential risks within the framework of the purchasing and payment cycle must be determined and responses to risks should be prepared. These phases can be determined as purchase requisition, purchase order, receiving, accounting and payment. Personnel who are running at these stages must be authorized. In accordance with the principle of segregation of duties, each phase must be executed by a different employee. Operations held in phases must be documented. Protection of entities and data should be provided. Phases should provide independent reconciliation with each other and with non-business parties. In this way, fraud, billing tricks and expense tricks from employees, vendors and employee-employee collaborations, employee-vendor collaborations at the businesses could be avoided.