UNIVERSITY OF TOLEDO INTERNAL AUDIT DEPARTMENT
PROCESS ACCOUNTS PAYABLE

Control practices

The following control objectives provide a basis for strengthening your control environment for the process of processing accounts payable. When you select an objective, you will access a list of the associated business risks and control practices. That information can serve as a checklist when you begin reviewing the strength of your current process controls.

This business risk and control information can help you assess your internal control environment and assist with the design and implementation of internal controls. Please note that this information is at the generic business process level and many companies will need to go beyond generic models to address the specific business processes that support the financial and nonfinancial disclosures being made. You can combine the insight of this business risk and control information with your industry-specific knowledge and understanding of your company's environment when conducting internal control assessments and designing and implementing recommendations.

Effectiveness and efficiency of operations

A. Accounts payable records and cash disbursements are safeguarded.
B. Costs are reduced as much as possible.
C. Processing time is minimized.
D. Employees and management are given the information they need to control the accounts payable process.
E. Management develops strategic business alliances with suppliers.

Reliability of financial reporting

A. Accounts payable and cash disbursements are properly authorized.
B. All liabilities are recorded on a timely basis.
C. Accounts payable are accurately and completely recorded on a timely basis.
D. The company accurately records returns and allowances for all authorized credits, and only for such credits.
E. Cash disbursements are accurately and completely made and recorded on a timely basis.
F. Accounts payable and cash disbursements are reliably processed and reported.
G. Recorded accounts payable balances are substantiated.
H. Recorded accounts payable balances are evaluated.
I. Performance measurements used to control and improve the process are reliable.

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Effectiveness and efficiency of operations

A. Accounts payable records and cash disbursements are safeguarded.

Business risks

- Unauthorized individuals will access accounts payable records and stored data.
- Misappropriations and fraudulent payments will occur.
- Physical security over cash and documents used to transfer cash will not be adequate.

Control practices

1. Restrict access to accounts payable systems and files to authorized personnel only.
2. Restrict access to blank checks and account for them periodically.
3. Ensure that check stock is sequentially pre-numbered and check numbers are reviewed and reconciled on a regular basis.
4. Restrict access to mechanical check signers and signature plates to authorized personnel only.
5. Establish adequate physical and logical security controls to ensure the integrity of the computer programming logic for electronic funds transfers (for example, to identify and authorize the originator, to check the reasonableness of transactions and transaction limits, and to validate account numbers for banks).
6. Reconcile bank accounts in a timely manner.
7. Segregate the following functions and duties: accounts payable, purchasing, receiving, vendor maintenance, goods receipt, payables invoice processing, disbursement preparation, disbursement approval, disbursement processing, recording of cash disbursements, bank reconciliations, approval of bank reconciliations, other accounts payable accounting/maintenance, and general ledger functions.
8. Ensure that personnel separate from those that enter and match invoices approve the release of checks for printing and signing.
9. Prohibit checks from being made payable to the bearer.
10. Require multiple people to sign checks that exceed a certain amount.
11. Deposit all receipts intact on a daily basis.

B. Costs are reduced as much as possible.

Business risks

- Excessive costs will be incurred.
- Payment delays will lead to interest charges.
- Invoices will be paid prior to their due dates.
- Multiple payments will be processed for the same vendor.
- Purchase discounts will be lost due to delays in receiving and processing documents, and/or non-compliance with vendor discount policies.
- Terms in vendor agreements will be violated, resulting in vendor dissatisfaction.

Control practices

1. Leverage discount policies, as appropriate, when selecting vendors.
2. Maintain the accounts payable ledger by discount date.
3. Require vendors to consolidate accounts payable invoices and accept a single payment for the total, when feasible.
4. Integrate purchasing, accounts payable, and accounts receivable to reduce errors in the information process and increase operational efficiency.
5. Review weekly or monthly cash requirements.
6. Edit exclusively transactions that are significant in dollar amount or unusual in nature (for example, check arithmetic extensions, approvals, signatures, and authorizations).
7. Review historical error patterns.

C. Processing time is minimized.

Business risks

- The accounts payable area will be overstaffed.
- Higher than necessary costs will be incurred in accounts payable.

Control practices

1. Empower employees closest to the user to authorize payment and charge appropriate accounts.
2. Distribute accounts payable workload efficiently (for example, base workload on transaction complexity, volume, or materiality).
3. Monitor efficiency in processing through relevant performance measures, such as error rates, invoices processed per AP technician, time to pay an invoice, or number of invoices processed per day.

D. Employees and management are given the information they need to control the accounts payable process.

Business risks

- Information provided to employees and management about the accounts payable process will conflict with company objectives.
- Employees will not improve the accounts payable process continuously over time.
- Employees and management will not accurately determine whether the accounts payable process is responding to vendor expectations.
- Plans to improve the accounts payable process will be based on incorrect perceptions about process performance, and the nature, number, and size of vendor invoices.

Control practices

1. Develop relevant performance measures that align the accounts payable process with company objectives.

E. Management develops strategic business alliances with suppliers.

Business risks

- Optimal results will not be achieved in the accounts payable process.
- The company will lose competitive advantage to companies that increase efficiencies by developing technological linkages and strong partnerships with suppliers.
- Adversarial approaches will produce suboptimal results for both the company and its suppliers.

Control practices

1. Empower management to develop strategic business alliances with suppliers by involving them in developing better ways to process accounts payable.
2. Perform due diligence on potential preferred vendors.
3. Develop preferred vendor partnership arrangements and subject them to legal review.
4. Leverage technology such as EDI and extranets to streamline accounts payable processing and build better linkages with preferred vendors.

Reliability of financial reporting

A. Accounts payable and cash disbursements are properly authorized.

Business risks

- Invoices for products and services that were not delivered or were unsatisfactory will be accepted for processing.
- Transactions will be initiated with unauthorized vendors.
- Invalid accounts payable will be fraudulently created to divert cash disbursements.

- Sensitive payments will occur.
- Purchases or services will be ordered and received by unauthorized individuals.
- Duplicate payments will occur, or payments will be made for the wrong amount or to unauthorized or non-existent suppliers.
- Payments will be made for goods and services not received.
- Electronic fund transfers will not be controlled.

Control practices

1. Instruct suppliers on purchase orders or equivalent documents to forward their invoices directly to accounts payable.
2. Attach adequate supporting documentation to all invoices processed for payment, including approved expense statements and check requests.
3. Compare freight bills above a limit established by management to the supporting shipping or receiving documentation prior to payment.
4. Ensure specific limits are set to establish signing authority for checks, promissory notes and bank transfers.
5. Deliver signed checks and promissory notes for mailing to persons independent of invoice processing and maintenance of accounts payable records.
6. Require accounts payable employees to regularly review debit balance accounts and request remittances on debit balances outstanding for more than 90 days.
7. Ensure that accounts payable personnel reconcile batch totals of the invoices entered for the day with a post-input report of invoices entered into the accounts payable system.
8. Ensure that the vendors, quantities, price, extensions, footings payment terms (including available discounts), supplier name and code, purchase order reference, and accuracy of the account distribution are agreed between the invoice receiving report and the purchase order.
9. Implement computer system routines that automatically match the invoice transactions entered to computerized records of purchase orders and receiving reports.
10. Ensure that the computer system identifies the purchase order as "closed" once a purchase order is matched to an invoice to prevent resubmission for payment.
11. Ensure computer system routines approve invoices for payment when an exact match between invoice data, purchase order data, and receiving report data exists.
12. Ensure computer system routines highlight checks or electronic payments over a prescribed dollar amount on a special report.
13. Implement access control software to ensure invoices and payment override authorizations are accepted from only authorized sources.
14. Ensure that one-time and initial standing wire transfer requests are accompanied by appropriate supporting documentation.
15. Ensure that only authorized treasury personnel initiate wire transfers and that bank callback verification procedures are in place.
16. Support requests for manual checks with purchase agreements, receiving reports, original invoices, or other documentation that indicates the propriety of the expenditures.

B. All liabilities are recorded on a timely basis.

Business risks

- Liabilities will not be recorded for goods and services received.
- Incomplete data entry will result in inefficiencies and errors.
- Discrepancies will exist between the general ledger and accounts payable trial balance.
- Vendor information for reporting requirements will not be complete.

Control practices

1. Ensure all vendor invoices are logged in and/or sequentially numbered as they are received, or that each invoice is recorded on pre-numbered accounts payable vouchers.
2. Ensure computer routines automatically accrue liabilities for major services not checked under normal processing such as telephone, electricity, and other utilities.
3. Implement computer system routines to identify receiving records that have not been matched to invoices for an excessive amount of time in ensuring that all liabilities are properly accounted for.
4. Generate a monthly report that lists receipts for which a supplier invoice has not been received and require the accounts payable department to use the report to accrue for related materials/services in the month of their receipt.

C. Accounts payable are accurately and completely recorded on a timely basis.

Business risks

- Purchases and cash disbursements will not be recorded, or will not be recorded on a timely basis.
- Goods or services received will not be recorded accurately.
- Inaccurate transaction coding and posting errors in the accounts payable trial balance will result in non-value-added activity to correct the errors.
- Payments will be made to the wrong parties and disbursements will be recorded for the wrong amounts because of clerical or mechanical processing errors.
- Credit and debit memos will be missing from the records because of errors like unrecorded adjustments.
- Purchase discounts will not be accurately calculated and properly recorded.
- Tax on purchase orders will be incorrect.
- Payment in foreign currency is inaccurately calculated.

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1. Use batch totals before completing the payment process for computer systems that input disbursements into a temporary file.
2. Check quantities, prices, extensions and footings of invoices, accuracy of account distribution, and proper approvals prior to general ledger journal entry.
3. Establish procedures to ensure period end reconciliation of the accounts payable ledger to the general ledger as well as to correct cut-off errors on a timely basis.
4. Ensure unprocessed receiving reports and invoices are reviewed periodically and then investigated and resolved.
5. Determine control totals prior to inputting invoices. Ensure computer routines reconcile this amount to the total of invoices accepted or rejected during systems processing.
6. Configure the accounts payable system to calculate applicable discounts per management policy.
7. Compare the tax per invoice to the estimated tax per the initial purchase order and ensure that the initiator of the purchase order and the tax department review significant variances.
8. Ensure the tax department reviews all foreign taxes due to their complexity.
9. Configure the accounts payable system to flag all payments in foreign currencies for calculation of foreign currency translation by an accounts payable clerk and for review by the accounts payable manager.
10. Require accounts payable clerks to calculate foreign currency translations offline and accounts payable managers to review the calculations.
11. Configure the computer system to pull automatically the payees' name and address from the approved vendor master file.
12. Configure the computer system to input automatically payment amount information from the invoice matching process.
13. Pay all checks sequentially on numbered checks.
14. Ensure that any difference between the payment amount and the invoice amount are automatically put into a suspense file for management review.
15. Ensure that the accounts payable system allows no difference in the payment date and the date of the check.
16. Ensure all source documents or invoice input records are properly cancelled after payment.
17. Review supplier statements for past due items and open credits.
18. Review accounts payable aging periodically to ensure payments have been recorded.
19. Ensure that the accounts payable system updates the corresponding cash and accounts payable accounts as of the check run date.
20. Ensure that the accounts payable department records debit memos and reconciles them to the hardcopy debits provided by the supplier.
21. Prepare for accrual purposes a listing of outstanding purchase orders for which ownership of goods is transferred prior to delivery.

D. The company accurately records returns and allowances for all authorized credits, and only for such credits.

Business risks

- Documents or information will be missing.
- Lack of controls will lead to unauthorized input for non-existent returns.
- Returns, allowances, or other adjustments will not be approved.

Control practices

1. Ensure shipping orders for returned goods are pre-numbered and accounted for.
2. Ensure shipping orders for returned goods are matched to the vendor's credit memos.
3. Identify unmatched shipping orders for returned goods with related receiving reports and invoices.
4. Resolve missing, duplicate, or unmatched items with individuals independent of the accounts payable function.
5. Review vendor correspondences that authorize returns and allowances.
6. Create return approvals for each return request and maintain supporting documentation in case of supplier dispute.

E. Cash disbursements are accurately and completely made and recorded on a timely basis.

Business risks

- Payments will be made to the wrong vendors or for the wrong amounts.
- Cash disbursements will be miscoded, resulting in misstated assets and expenses.
- Cash disbursements will not be made within management's required timeframe to take advantage of discounts or terms agreed upon with suppliers.
- Valid cash disbursements will not be recorded in the accounts payable subsidiary ledger or in the general ledger.
- Inputs for preparation of journal entries and cash disbursement records will be inaccurate.

Control practices

1. Require all cash disbursements to be made on sequential and pre-numbered checks and promissory notes.
2. Require individuals who sign checks to be different than those who approve the related invoices.
3. Compare checks, once paid, by amount, date, and payee, either individually or together.
4. Generate daily management reports from computer systems to illustrate anticipated cash disbursements by date.
5. Ensure the computer system will automatically post the appropriate accounting entry to reflect payments in the accounts payable records.

F. Accounts payable and cash disbursements are reliably processed and reported.

Business risks

- Unauthorized program changes will cause unauthorized processing results.
- Use of unauthorized versions of files and/or program will result in unauthorized or incorrect business transactions.
- Files (transaction, reference or master) will be lost, altered or damaged, resulting in inefficiencies, lost assets, or incorrect processing of transactions.

Control practices

1. Establish controls to maintain the integrity of the programs used to process transactions, including authorizations to change programs and computer system security controls.
2. Utilize only authorized versions of programs and files for transaction processing.
3. Establish logical security controls to safeguard check signing programs and confirm they are functioning as designed.

G. Recorded accounts payable balances are substantiated.

Business risks

- Unauthorized transactions will be recorded and remain undetected.
- Errors in the processing, summarization, and recording of purchase transactions will remain undetected.
- Unrecorded receipts of goods and services will not be detected.
- Postings to the purchase ledger control account and cash in the general ledger will be inaccurate or incomplete.
- Postings to the accounts payable and expense accounts in the general ledger will be inaccurate or incomplete.

Control practices

1. Segregate the maintenance of the accounts payable subsidiary records from employees who check and approve accounts payable documents or maintain the accounts payable control account.
2. Compare recorded balances periodically to budgeted amounts and prior period amounts.
3. Reconcile accounts payable subsidiary records periodically with supplier statements.
4. Reconcile statements received from suppliers to the suppliers' accounts in the accounts payable sub-ledger regularly.
5. Reconcile the total of checks issued with the updates to the accounts payable sub-ledger and cash account.
6. Reconcile accounts payable records with vendor statements periodically.
7. Perform bank reconciliations to check for old reconciling items.

H. Recorded accounts payable balances are evaluated.

Business risks

- Recorded balances will not reflect realistic valuations under conditions existing at a particular date.

Control practices

1. Review the accrual process periodically for reasonableness.
2. Evaluate periodically allowances for litigation, losses on purchase commitments, and warranty allowances.
3. Review and approve provisions for allowances and adjustments to allowances before they are made.

I. Performance measurements used to control and improve the process are reliable.

Business risks

- Recorded balances will not reflect realistic valuations under conditions existing at a particular date.

Control practices

1. Collect data periodically on the accounts payable process to assess its performance.
2. Review periodically performance measures to ensure they represent process performance.
3. Utilize vendor surveys, complaints, and questions to gather relevant information about the accounts payable process and to facilitate performance measurement.