

UNIVERSITY OF TOLEDO INTERNAL AUDIT DEPARTMENT

HANDLE WARRANTIES AND CLAIMS

Control practices

The following control objectives provide a basis for strengthening your control environment for the process of handling warranties and claims. 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. All claims are handled on a timely basis.
- B. Customers are satisfied with the processing of their claims.
- C. Warranty strategy is aligned with marketing and financial strategies.
- D. Relevant information is used to eliminate underlying causes of claims.
- E. Employees and management have the information they need to control the claims handling process.
- F. Useful information about the reasons for claims is obtained from the claims handling process.
- G. Claims are properly authorized.
- H. All authorized claims are accurately and completely recorded on a timely basis.
- I. All authorized claims are reliably processed and reported.
- J. Senior management's expectations about claims process performance are defined and communicated.

Compliance with applicable laws and regulations

- A. Warranty terms comply with laws and regulations.

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Effectiveness and efficiency of operations

A. All claims are handled on a timely basis.

Business risks

- Delays in resolving claims will reduce customer satisfaction.
- Long outstanding claims will be difficult and time-consuming to resolve.
- Double-handling of unresolved claims will cause inefficiencies.

Control practices

1. Empower the customer contact with the authority to resolve claims at the initial point of contact.
2. Provide claims personnel with the information required to research and resolve claims at the initial point of customer contact.
3. Implement processes to facilitate timely communication of claims decisions by sales and service personnel so the claims can be promptly processed and reported.
4. Use performance measures to monitor responsiveness to customer claim issues (for example, the average time to resolve a claim, the number and percentage of claims resolved within a specified time period, and the number and percentage of claims resolved with the initial phone call).

B. Customers are satisfied with the processing of their claims.

Business risks

- The company will lose future business.
- The company will incur bad publicity and poor word-of-mouth comments.
- The company will face lawsuits.

Control practices

1. Give customers information about the claims process at the point-of-purchase.
2. Resolve a majority of claims after the first call from customers.
3. Receive only a few, if any, complaints from customers about the claims process.
4. Reduce the number of customers who pursue legal recourse to resolve claims to only a few, in any at all.

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C. Warranty strategy is aligned with marketing and financial strategies.

Business risks

- Liabilities for warranty claims will exceed acceptable levels.
- Warranty periods and terms will conflict with marketing claims about the product.

Control practices

1. Require that cross-functional teams (marketing, financial, production, and engineering personnel) develop warranty strategies.
2. Examine the company's warranty experience periodically to ensure product performance remains consistent with the warranty period and marketing strategy.
3. Examine the company's warranty experience periodically to ensure that warranty costs and exposure remain within acceptable financial guidelines.
4. Ensure that all personnel who handle warranties and claims (financial and operations) understand the warranty terms and obligations.
5. Require that financial and operations personnel consider the financial risks of warranty programs by factoring in their impact on total product life cycle costs.

D. Relevant information is used to eliminate underlying causes of claims.

Business risks

- The claims pattern will continue to produce higher costs and lower customer satisfaction.

Control practices

1. Promote cross-functional communication between design, manufacturing, engineering, production, and sales personnel about the nature and extent of claims and their underlying causes.

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E. Employees and management have the information they need to control the claims handling process.

Business risks

- Information given to employees and management about the claims handling process will conflict with company objectives.
- Employees will not improve the claims process on a timely basis.
- Employees and management will not be able to accurately determine whether the claims process is operating as planned.
- Plans to improve the claims process will be based on incorrect perceptions of process performance and on the nature, number, and sizes of claims being made.

Control practices

1. Establish relevant performance measures for the claims handling process.
2. Use quantifiable and controllable performance measures to monitor the claims handling process.
3. Provide performance measure reports to management in a timely manner.

F. Useful information about the reasons for claims is obtained from the claims handling process.

Business risks

- The causes of errors will not be eliminated if the company fails to analyze the reasons for claims.
- The claims handling process will not produce the information necessary to identify the causes of claims.

Control practices

1. Develop a system of codes for certain types of claims. Ensure that the codes record the reasons for the claims for future analysis.
2. Ask customers to submit requests for claims on standardized forms that include fields for indicating the reason for the claim and any other comments.

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G. Claims are properly authorized.

Business risks

- Claims will be processed to accounts without management approval.
- Inaccurately processed claims will lead to further claims and customer dissatisfaction.

Control practices

1. Ensure the validity of the customer claim and verify both the terms for all claims and the proof of returned goods before approving the claim and recording the claim transaction.
2. Assign all customer claims a unique reference number in the claims system for identifying the transaction and tracking the disposition of returned goods.
3. Identify all claims separately in the claims system using detailed descriptions of the claim background (for example, the product description and code, reference to the original purchase order and invoice, reference to the original receipt and customer signature, the customer's claim, and the action taken).
4. Implement computer system controls that prevent unauthorized individuals from processing claims and issuing credit transactions.

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H. All authorized claims are accurately and completely recorded on a timely basis.

Business risks

- Claims made and approved will not be reported. Accounts receivable will be overstated.
- Claims under investigation will not be reported for liability recording purposes.

Control practices

1. Count and inspect physically the goods at the time of the return to verify that they are either defective or were the wrong goods. Record significant information, such as the quantity returned, description of the goods and their defects, and the purchase and return dates, on the receiving report.
2. Build an indicator into the invoicing system and accounts receivable system to signal a claim has been made and is being processed to prevent duplicate submission and processing of the same claim transaction.
3. Check the quantities and descriptions of returned goods automatically against the original shipment records during the credit processing function.
4. Apply computer routines that automatically post the credit to the appropriate financial records based on amounts originally recorded on invoice records and price master file records.
5. Configure the claims system to generate reports of all credit transactions issued for a specific period due to product return claims.
6. Require that claims analysts reconcile predetermined control totals of claims transactions submitted to the system with the results of processing to ensure that all claims are processed accurately.
7. Reconcile returns to inventory and to vendors with all claims processed to ensure proper accounting for returned goods.
8. Apply computer routines that simultaneously record credits and stock returns as claims are processed or at the end of each day.
9. Prepare a report of daily return activity to summarize significant information, such as returns to inventory, goods segregated for return to vendor, and goods segregated for repair.

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I. All authorized claims are reliably processed and reported.

Business risks

- Unauthorized changes will be made to programs, leading to unauthorized processing results.
- Unauthorized versions of files and/or programs will be used to process transactions, resulting 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. Implement controls to maintain the integrity of the programs used to process transactions. Include controls such as requiring authorization for all changes to program routines and limiting access to these systems to prevent unauthorized credits.
2. Ensure that only authorized and up-to-date versions of programs are used to process claims transactions.

J. Senior management's expectations about claims process performance are defined and communicated.

Business risks

- Efforts and costs of claims management will not be consistent with management expectations.
- The claims handling process will not be consistent with the company's overall strategies.

Control practices

1. Create a mission statement for managing claims.
2. Develop specific strategies and tactics to achieve the mission of the claims process.
3. Implement formalized reporting structures and assign accountability to claims personnel to achieve management objectives.

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Compliance with applicable laws and regulations

A. Warranty terms comply with laws and regulations.

Business risks

- Disclosures about warranty will not comply with applicable laws and regulations.
- Warranty terms will mislead customers, resulting in customer dissatisfaction and legal action.

Control practices

1. Perform a legal review of the company's warranty policy.
2. Perform a legal review of the adequacy and timing of disclosures related to the warranty policy.
3. Evaluate customer complaints in terms of the need for clarifying the company's warranty policy.
4. Review the nature and extent of customer complaints about claims to improve the claims process.