



Indirect Spend: Procurement Controls and the Impact of Sarbanes-Oxley

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Agenda

- **Legislation Basics**
- **Evaluation of Supply Chain**
 - Process level assessment
 - Financial Statement Assertions
 - Documenting
 - Assessing Control Design
 - Testing Control Operation
- **Evaluation Framework**
- **Supply Chain Considerations**
- **Closing**

Section 404 What is it?

- **Requires Public companies to include the following items in their annual financial reports:**
 - Management's declaration of responsibility for internal controls
 - Identification of the control framework used
 - Management's assessment of internal controls
 - External auditor attestation to management's evaluation of internal controls

- **Other applicable sections**
 - 401a – Off balance sheet transactions
 - 409 – Timely reporting of material events that impact financial statement reporting

Sarbanes-Oxley 404 and COSO

- **Section 404 Requires Public companies to identify in their annual financial reports:**
 - responsibility and attestation of internal controls
 - An attestation by the external auditor to management's evaluation of internal controls
 - Utilization of a control framework

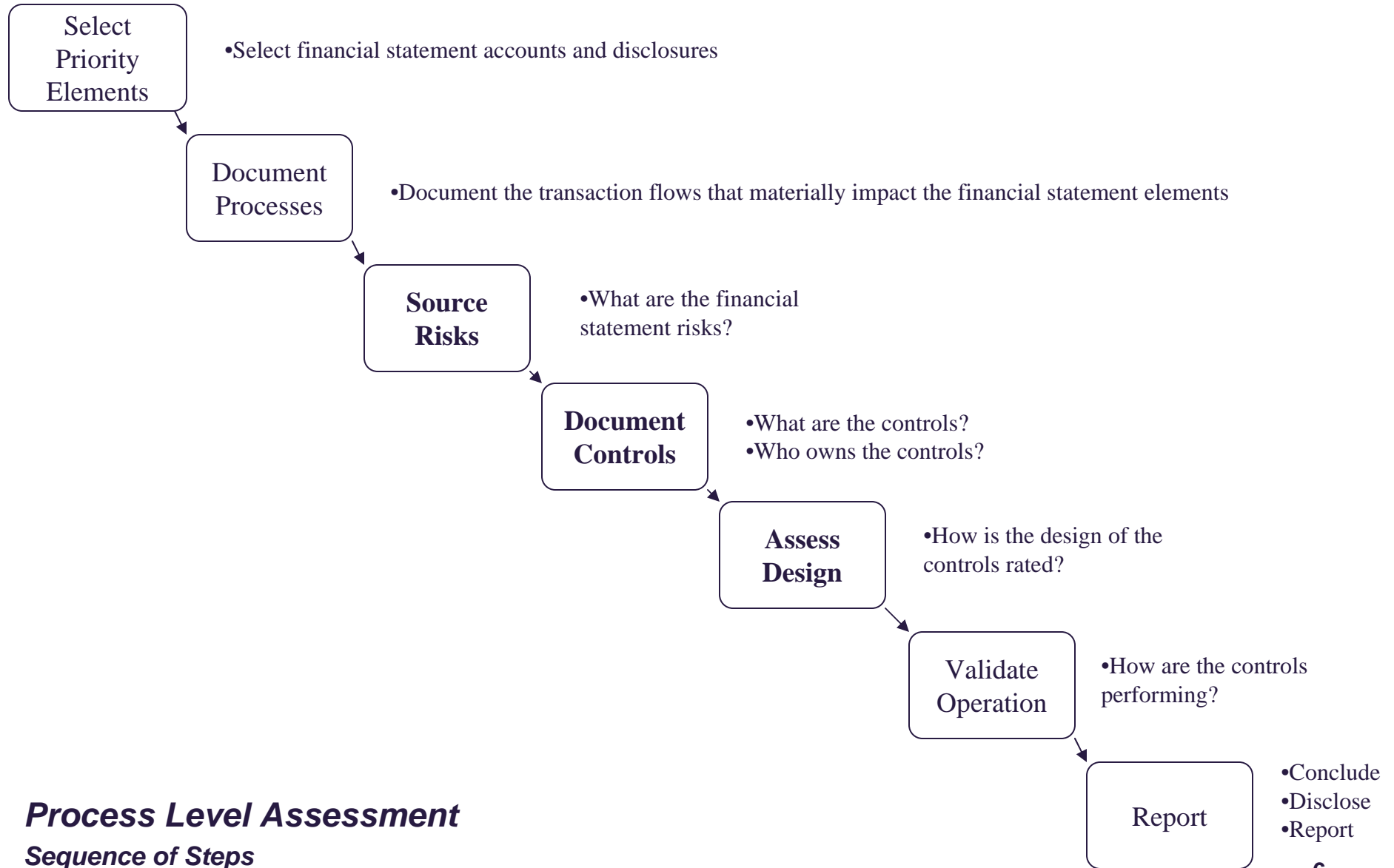
COSO CONTROL FRAMEWORK

- **Control Environment:**
 - Tone at the Top
- **Risk Assessment**
 - Imbedded risk in the business place
- **Control Activities**
- **Information & Communication**
 - Data tools and personal interfaces
- **Monitoring**
 - Oversight, mitigation and remediation



Evaluation of Supply Chain Connection

- **Determine which accounts have significant impact**
 - Asset/Liabilities (including physical inventory)
 - Expenditure cycle
 - Including contract labor and materials
 - Revenue cycle
 - Revenue for services sold
 - Authorization process
 - Authorization of supply chain/procurement transactions
 - Commitments & contingencies
 - Off balance sheet transactions

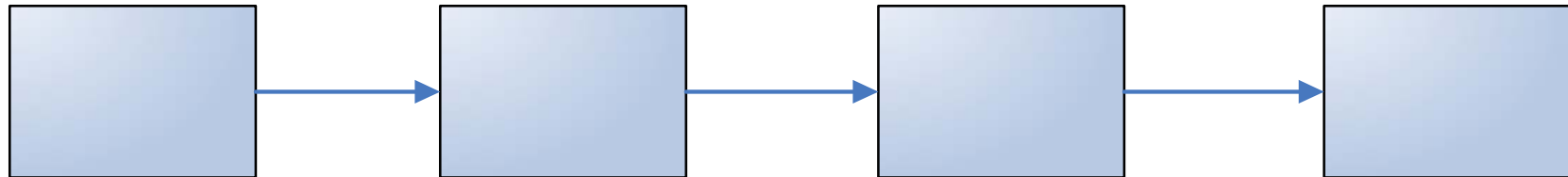


Process Level Assessment
Sequence of Steps

Financial Statement Assertion Linkage

- ***Existence*** – exist at a point in time
- ***Occurrence*** – events actually occurred
- ***Completeness*** – transactions are recognized and recorded
- ***Rights and Obligations*** – transactions are bona fide
- ***Valuation or Allocation*** – transactions are recorded at appropriate amounts
- ***Presentation and disclosure*** – transactions are properly described, classified and presented

Documenting Processes/Sourcing Risks/Documenting Controls



- Requisition
- PO
- Negotiation
- Contract
- Corporate Approval/ authorization process

- System controls/edits
- Transaction validation
- LT contract considerations
- Commitments/contingencies
- Liability exposure

- Transaction authorization & approval
- Invoicing
- Receipting
- Segregation of duties
- System edit controls & data access
- Exception reporting, matching/validating
- Monitoring compliance
- Key forms, documents and records

- What reports may be used as inputs to other processes
- Contract Administration

Assessing Control Effectiveness

- **Design Effectiveness**
 - Is control suitable to prevent/detect material misstatements?
 - Consider individual companies materiality levels
- **Controls should provide reasonable assurance that risks are reduced to an acceptable level. Consider:**
 - value of individual control
 - process efficiency
 - monitoring/reporting of deviation from control
 - experience of individuals executing the control
- **Determination and definition of “acceptable level” must be made**

Testing Effectiveness of Control Operation

- **Operating Effectiveness**
 - Deficiency if controls do not function as designed or person performing the control isn't qualified or authorized

- **Testing requirements:**
 - Test all key controls
 - Inquiry is not sufficient evaluation
 - Document results
 - Management must instill processes to “test” their own transactions

Evaluation Framework

Material Weakness

(PCAOB Definition)

“a significant deficiency that, by itself, or in combination with other significant deficiencies, results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.”

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MATERIAL

CONSEQUENTIAL

INCONSEQUENTIAL
(Of minimal importance)

Insignificant Deficiency	Material Weakness (Reported in SEC filings)
Insignificant Deficiency	Significant Deficiency (Reported internally)
Insignificant Deficiency	Insignificant Deficiency

REMOTE

MORE THAN REMOTE

LIKELIHOOD

Measurement of financial statement effect

Inconsequential

- No material affect on the company's financial statements

Significant

- Could adversely affect the ability to report on financial data consistent with management's assertions

Material weakness

- Significant deficiency that alone or in the aggregate could keep internal controls from preventing or detecting misstatements

Supply Chain Considerations

- **The initiation process**
 - Sufficient documentation of transaction
 - Authority level and timely authorization
 - Policy compliance and policy application
 - Ensure policies are in-line with corporate/strategic directions
 - Fraud considerations
 - Non-approved suppliers
 - Employees paid as suppliers
- **Recording/Transaction processing**
 - Systems edits, controls and interfaces with financial reporting systems
 - Authorization policy
 - Segregation of duties
 - Contingent liabilities

Supply Chain Considerations

- **Third Party providers**
 - Contractual considerations when providing integral information to financial statements (SAS 70)
 - Normal supplier/vendor relationship not directly affected
 - “Audit clause”
 - Software/hardware supplier requirements for data processing (SAS 70)
- **Inventory Process**
 - Safeguarding of Assets (e.g. physical inventory controls, access to storerooms)
 - Policies/procedures
 - Obsolete inventory & write-offs
 - Segregation of duties
- **Maintenance of documentation**
 - Forms/policies/processes
 - Contract Administration processes
 - Sign-offs

The Bottom Line

- **Controls should.....**
 - be adequate to meet financial statement assertions
 - be “implementable” & in line with corporate strategic goals/objectives
 - provide “reasonable assurance”
 - be effective/efficient for operations

- **Controls should “NOT”.....**
 - Stop the business from operating
 - Establish ineffective/cumbersome routines
 - Be in place “just because”



Final Thoughts

- **There is “no” one-size fits all for Sarbanes**
- **Understand the “basics” of the rules**
- ***Be “aware” of those attempting to “sell” control processes***



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QUESTIONS ?????