

Managing Vendor Risk Across the Procure to Pay Value Chain

Presenters



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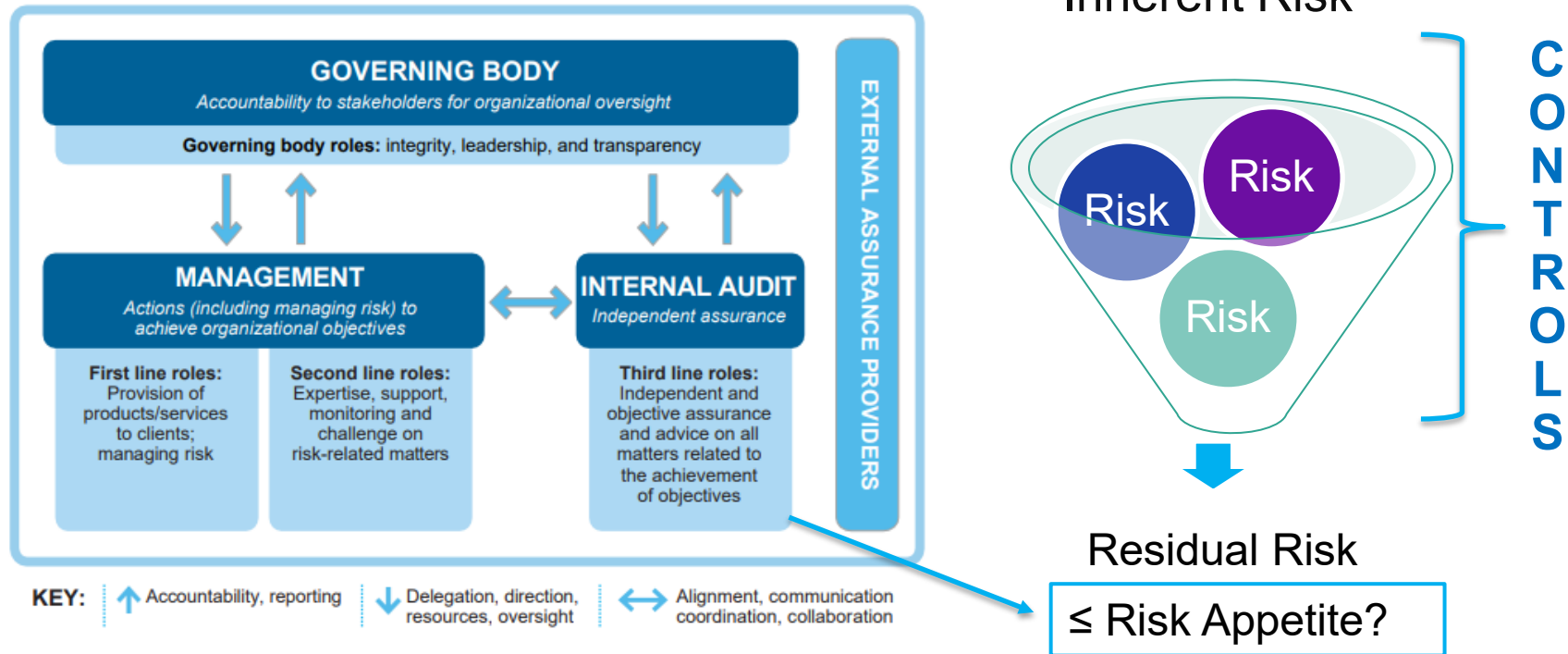
Agenda

- Internal Audit's Role in the Three Lines of Defense and Internal Control
- Key Risks and Trends Associated with the Procure to Pay Process
- Market and Recovery Trends
- Why Errors Occur and Where Overpayments are Commonly Found
- Commercial Compliance
- Contracting Risks and Mitigation Techniques
- Audit Techniques vs Real-Time Risk Mitigation Techniques

Internal Audit's Role in the Three Lines of Defense and Internal Control

Internal Audit's Role

The IIA's Three Lines Model



Three Lines Model (Principal 6): Creating and protecting value - All roles working together collectively contribute to the creation and protection of value when they are aligned with each other and with the prioritized interests of stakeholders.

Source: The IIA

Key Risks and Trends Associated with the Procure to Pay Process

Key Risks Associated with Procure to Pay

- Mergers and acquisitions
- Ineffective contract administration
- Slow payment to vendors
- Vendor master file is not well maintained
- Purchase Orders are not used effectively
- Disparate Systems (ERP, order management, and warehouse management system)
- Poor spend visibility
- Recent system implementations

Key Risks Associated with Procure to Pay

- Multiple methods and systems of payment
- Higher volume of invoice activity
- Employee turnover or recent outsourcing
- Decentralized procurement and AP functions
- Poorly designed controls or poor execution
- Supply chain disruptions (material shortages, logistics challenges, global crisis)

Market and Recovery Trends

- Digitize spend management and automate AP
- Artificial Intelligence and CAT embedded audit techniques
- Cloud based solutions
- Customize workflows to streamline repetitive accounts payable tasks such as data entry
- Include document capture and imaging features to convert paper invoices into electronic documents
- Provide a single repository for users to search and retrieve AP documents
- Remote approval processes for payments, debits, or any modifications to AP transactions
- Comply with accounting standards and regulations for AP processing

Digital Supply Chain Security Risks

Main Categories of Digital Supply Chain Security Risks



Source: Gartner
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Why Errors Occur and Where Overpayments are Commonly Found

AP Processing: Where Errors Are Commonly Found

Perform Data Analytics on Invoice History for Payment Errors

- Duplicate payments
- Duplicate billings
- Pricing discrepancies
- Missed cash discounts

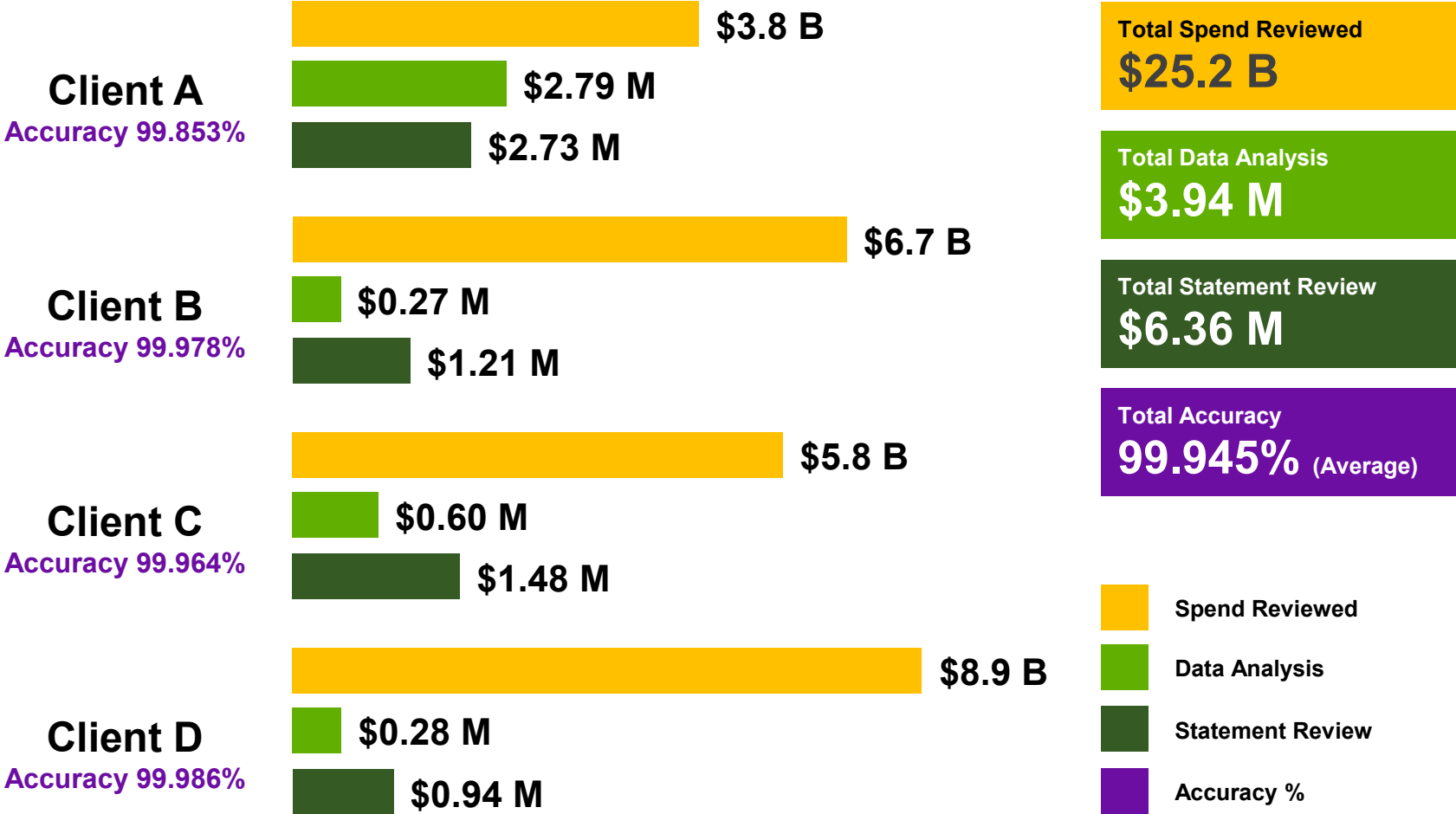
Review of Supplier Statements of Account for Recovery Opportunities

- Erroneous payments
- Returned items
- Rebates/deposits

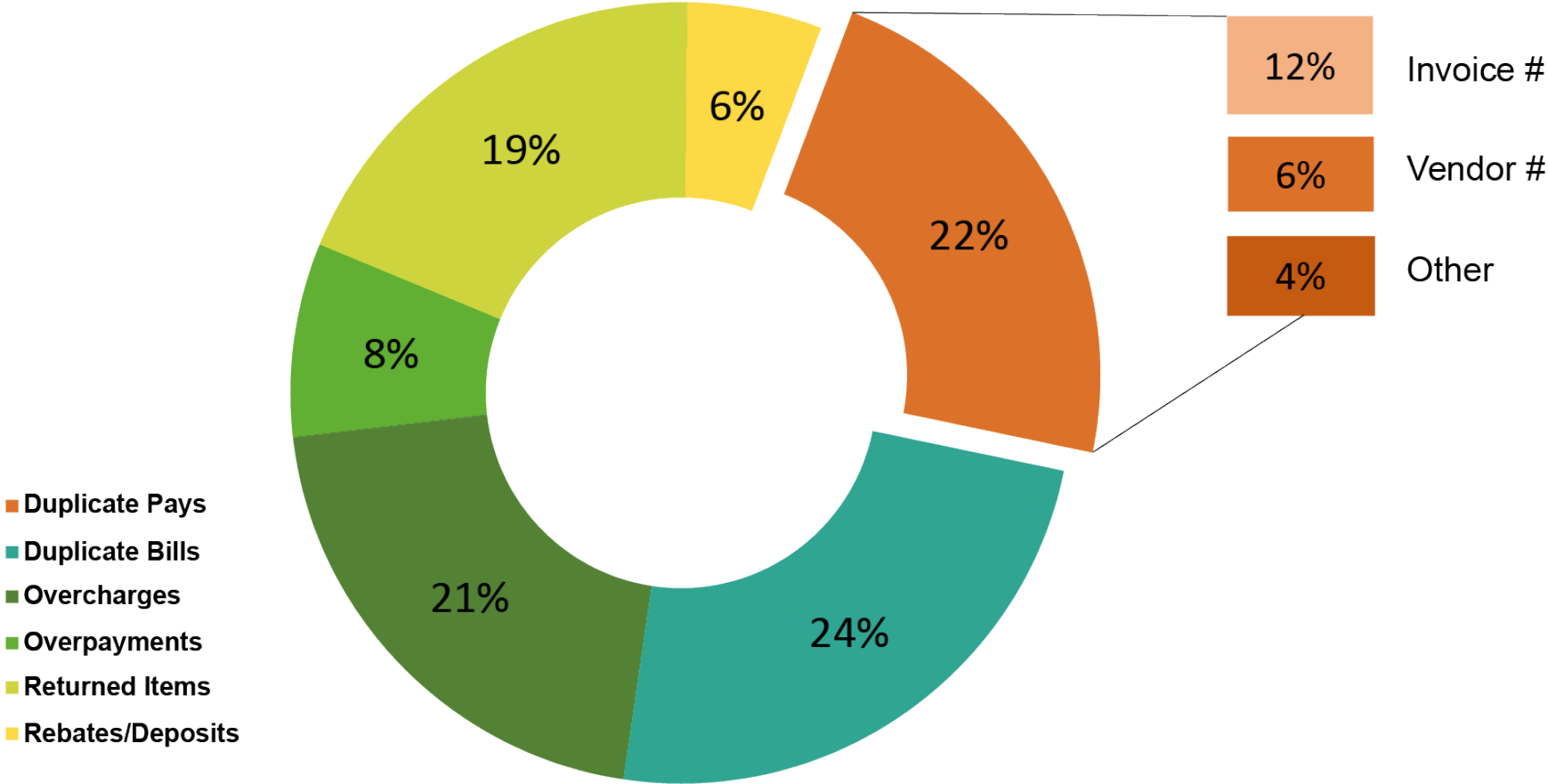
Additional Areas of Risk and Opportunity

- Vendor master cleansing
- Forensic and risk reporting
- Process efficiency analysis

AP Processing: Benchmarks



AP Processing: Where Errors Are Commonly Found



Commercial Compliance

Where to start? | What to look for? | How to prevent issues?

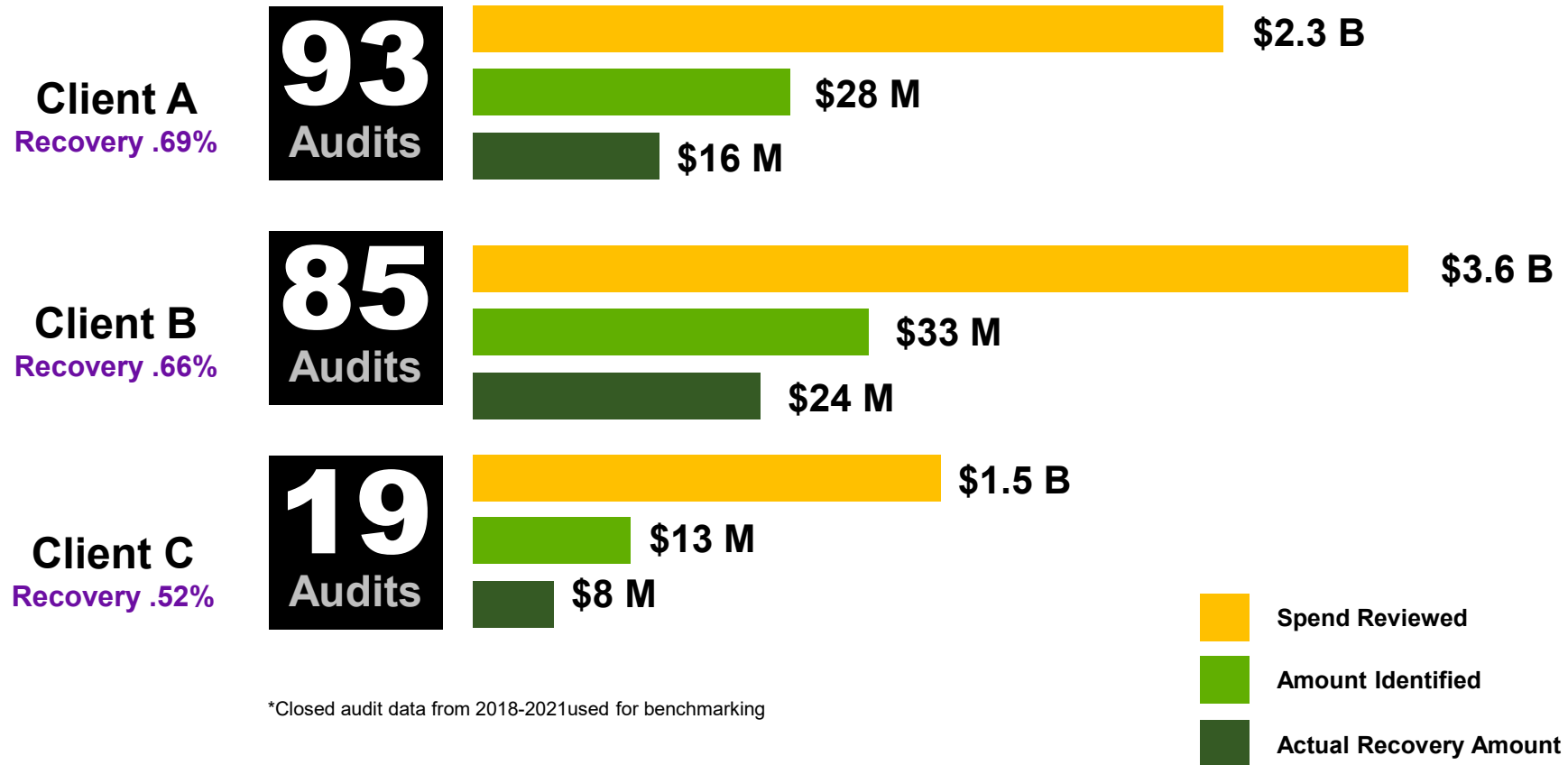
Common Issues Encountered- How to find and prevent

- Double billing for items (e.g., consumables & small tools)
- Incorrect rates and pricing
- Misapplication of rebates, discounts, margin, mark-up
- Discrepancies between GPS data and charges
- Freight billing issues
- Pay class vs. bill class issues have increased
- FUTA/SUTA/FICA tax are inappropriately billed - Reconciliation Language for cost plus build ups
- Hours billed do not match hours paid
- Owner employees invoicing time and overhead
- Credit memos being mishandled

Contributing Factors that can Increase risk

- Business growing too fast for some customer and their suppliers to process and controls to handle
- Supplier's workforce level of experience/training is lacking due to rapid growth, causing pricing errors and returns
- Integrating acquisitions into existing contracts
- Verbal agreements - handshake deals are hard to monitor or measure
- Growth activity outstripped original intent and spend levels
- Conflict of interest (i.e., related subsidiaries with hidden mark-ups)

Contract Compliance: Benchmark Recovery Rates



Why Perform Contract Compliance Reviews

- Gain transparency into supplier billing practices - Systemic/Human Error
- Implement cost reduction strategies - Finding the leakage (OCS)
- Improve contract terms and conditions - Contract Coverage
- Focused attention on complex contracts with high-spend strategic suppliers
- Gain historical view of activity against commercial terms
- Transform the Internal Audit department from a cost center into a **PROFIT CENTER**, by recovering hard dollars to your Company

Contracting Risks and Mitigation Techniques

What are the keys to auditable contracts?

How important is Contract Administration in overall Contract Life Cycle Management?

How can effective Contract Administration reduce retrospective audit findings?



Contract Formulation

What are the keys to auditable contracts?

Clear scope definition and deliverables

- Include Work Breakdown Structure (WBS code) level detail in the contract – becomes baseline and drives Key Performance Indicators (KPI)
- Include manpower forecast in the contract – becomes baseline and helps determine whether the contractor executed the work per their plan
- Include performance criteria in material and engineered equipment contracts
- Avoid blended pricing structures

Avoid “soft” contract language

- “Coordinate”, “Ensure”, “Monitor”, “Facilitate”, “Best Efforts”, etc.

Be specific – take time to define key words in the contract

- “On-Time Delivery”, “Deliverables”, “Products”, “Agreement” (what are the documents that are incorporated and part of the agreement/contract?)
- Define costs – clarity of pricing – clear commercial terms – include examples

Contracting Risks

A key element of Contract Administration is understanding the contracting risks. Begin with a Contract Language Risk Assessment and Risk Profile. Contracting Risk falls into six categories:

- **Financial Risk** – increased costs relative to current contract language
- **Operational Risk** – interruption, delays, work stoppage
- **Litigation Risk** – threat of litigation based upon misunderstanding, misinterpretation, ambiguity or related issue
- **Business Process Risk** – potential to incur some internal cost in having to address the consequence of an issue
- **Health, Safety, and Environmental Risk** – potential of exposure involving the safety of employees, facilities or the environment
- **Audit Recovery Risk** – The degree to which the owner can expect to identify issues and recover funds in the event of an audit

Contract Formulation: A Risk-Balanced Contract



■ Risk Shifted to Operator
■ Balanced Risk

Contract Formulation: Risk Levels We Find



Audit Techniques vs Real-Time Risk Mitigation Techniques

Auditing Techniques: Pros and Cons

Audit Techniques	Pros	Cons	Practical Reasons
Continuous / Real Time	<ul style="list-style-type: none"> • More proactive approach • Maximizes savings with less leakage • Likely to have a higher degree of leverage with suppliers • Continuously identify and improve process gaps 	<ul style="list-style-type: none"> • Higher up front capital investment required • More internal company time and resources needed 	<ul style="list-style-type: none"> • Poor controls • High degree of change (systems / turnover) • Non routine spend unusual high volume of invoices • Major Capital Projects
Retrospective	<ul style="list-style-type: none"> • Strong opportunity to recover overpayments • Able to benchmark against peers • Paints a bigger picture to develop a road map for driving improvements 	<ul style="list-style-type: none"> • Supplier relationship may have changed • Less leverage may limit ability to perform an audit. 	<ul style="list-style-type: none"> • Little change • Historical reviews have shown strong internal controls

Questions