# Accounts Payable and Sarbanes-Oxley

## Strengthening Your Internal Controls

Mary S. Schaeffer

John Wiley & Sons, Inc.

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Published by John Wiley & Sons, Inc., Hoboken, New Jersey.

Published simultaneously in Canada.

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***Library of Congress Cataloging-in-Publication Data:***

Schaeffer, Mary S.
Accounts payable and Sarbanes-Oxley : strengthening your internal controls / Mary S. Schaeffer.
p. cm.
Includes index.
ISBN-13: 978-0-471-78588-0 (cloth)
ISBN-10: 0-471-78588-1 (cloth)
1. Accounts payable—Management. 2. United States. Sarbanes-Oxley Act of 2002. I. Title.
HF5681.A27S285 2006
658.15'26—dc22

2005031927

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

For my anchors,
Lara, Ben, and Hal

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# Preface

As I went through the material for this book, several appalling facts became readily apparent. In more companies than I would care to count, the odds are there is something being done in accounts payable or one of its related functions that indicates the organization is *not* in compliance with all state and federal laws. I suspect that in a significant, albeit smaller, number of organizations, the internal controls in place would not be designated as being adequate when held up to the close scrutiny that the Sarbanes-Oxley Act requires.

But there is good news on the horizon. For starters, the newsletter *Accounts Payable Now & Tomorrow* polled its readers and discovered that more than a few are changing some of those really bad practices specifically because of the Act. You will find the results of this investigation scattered throughout the book as we reveal just where the force of the Act is being used most effectively. Savvy professionals are seizing the momentum offered by the current climate and the passage of the Act to improve processes and procedures that they have long understood to be inadequate. Sarbanes-Oxley has provided them with the political ammunition they needed to force these changes.

Interestingly, not all the changes are taking place at publicly traded organizations. Private companies and not-for-profits in large numbers are opening their eyes and in many cases are im-

posing the same discipline on their operations as is required under Sarbanes-Oxley. While some are doing it because it just makes good business sense, others are doing so under pressure from their bankers, key suppliers, or 800-pound gorilla customers.

This book begins with an overview of the Act and, more specifically, the sections that affect accounts payable and the functions related to it. It takes a look at several of the compliance alternatives including the COSO (Committee of Sponsoring Organizations) framework and outsourcing. Several themes emerged regarding accounts payable. Internal controls, segregation of duties, and compliance with all state and federal laws emerged and are repeated through a number of the sections.

Since the payment process is probably the one that virtually all accounts payable departments are responsible for, it gets its own section in the book. It is also the area where the company has the most on the line. Poor controls surrounding the payment process could result in a large fraud. In this area the issue of segregation of duties is also critical.

The payment section contains a chapter on purchasing cards. Much of the information comes from a survey completed by the members of the National Association of Purchasing Card Professionals. Without the support of this group, we would not have all the fine insights we have into the nuances of this function.

It is in the related areas where organizations sometimes run into trouble. We've taken a look at 1099s, travel and entertainment, unclaimed property, and sales and use tax and overlaid the Act on these functions to determine appropriate processes. In a number of these areas, as the *Accounts Payable Now & Tomorrow* poll revealed, there have been some significant control changes—and all we can say is "It's about time!"

Finally, in Part Four, we've provided overall guidelines to help accounts payable departments conform to the Act. This

includes information on preventing fraud, proper documentation, and the overall principles to structure your department so it will be in compliance.

There are several Appendices that provide ancillary information that may be used with regard to specific functions.

By the time you finish the book, we hope you will have a healthy respect for the internal controls needed in accounts payable and all related functions to help your company achieve its goal of a robust bottom line.

# Acknowledgments

This was a really neat book to put together. It was a little different in that it required marrying two sets of information. I have to thank the many accounts payable professionals who over the years have graciously shared their accounts payable experiences, both good and bad, with me. Without that intelligence, neither this nor any of the other accounts payable books I've written would have been possible.

The chapter on purchasing cards was put together with significant help from the National Association of Purchasing Card Professionals. These remarkable professionals undertook a joint project with *Accounts Payable Now & Tomorrow* to survey their members about the impact of the Sarbanes-Oxley Act on their purchasing card operations. That was extremely useful when it came to writing the chapter on purchasing cards. A special thanks to Diane McGuire, Laura Flanders, and Lynn Larson, who sifted through the data with me.

I also received a big boost for the chapter on unclaimed property, and for that I have to thank Karen Anderson of Unclaimed Property Recovery and Reporting (UPRR). A consummate professional, she shared her extensive knowledge and experience in that arena.

And, of course, this book would not have come to fruition without the support of John Wiley & Sons and especially Sheck Cho. I am very lucky to have such a knowledgeable and supportive editor.

# PART I

## The Basics

# 1

# Sarbanes-Oxley: How It Applies to Accounts Payable

Perhaps the most telling (and slightly amusing) story I've heard about accounts payable and Sarbanes-Oxley revolves around a discussion one very competent accounts payable manager had with her company's auditor after its Sarbanes-Oxley audit was completed. The auditor was not pleased that one of the accounts payable processors had not used the approved naming convention standards when entering information into the master vendor file.

The manager had been over this issue with her staff numerous times but was understanding of the fact that sometimes people forget. "It is what it is," she said, explaining the issue to the auditor.

"No, it ain't," was his reply. Overlooking the poor English, the conversation reflects the conceptual change that must take place in accounts payable operations if the organization has any hope of complying with Sarbanes-Oxley requirements. He had hit on one of the key facets of the Act as it relates to accounts payable. Strong internal controls are integral to the efficient operation of any well-run department. It will become

the mantra for accounts payable—regardless of whether the company in question is subject to the requirements of the Act.

Exactly what this attitude adjustment means to accounts payable, how it affects the daily operation, and how it is to be implemented is the focus of this book. Periodically, we'll refer back to the preceding discussion to reveal what changes this manager (and others like her) had to make to their operations to get in compliance with the Act.

## BACKGROUND

The Sarbanes-Oxley Act of 2002 is comprised of 66 sections, only a few of which will be discussed extensively in this book. As virtually everyone reading this is painfully aware, the enactment of this legislation was a direct result of numerous well-publicized accounting scandals, or some would say frauds. The intent was not only to close the loopholes that made these transgressions possible but also to hold management at the very highest levels responsible for what went on in their companies on their watch.

It was inevitable that increased accountability, in the form of fines and possible jail time, would trickle down to middle management. Few officers would willingly sign financial statements under such dire threats without requiring some sort of a guarantee from the minions who toiled on their behalf. Thus, quickly, subcertifications sprang up. These documents, also known as *cascading certifications* or *upstream certifications* (depending where you stand), are now found at a significant percentage of the companies interviewed.

## OVERVIEW OF THE ACT

The Act is broken into 11 main parts called *Titles*. Each of the Titles is further subdivided into portions called *Sections*. The most famous of the sections are probably:

- Whistleblower Protections (a/k/a Retaliation Against Informants)
- Auditor Independence
- Timely Disclosures
- Corporate Responsibility for Financial Reports
- Management Assessment of Internal Controls

While the whistleblower piece may be the second most interesting section, it does not greatly affect the accounts payable operations. Similarly, while it might be great fun to talk about chief executive officers (CEOs) and chief financial officers (CFOs) getting fined and possibly going to jail, we are not going to spend a lot of time discussing either of these issues. The main focus of this chapter and the remainder of the book will be on Section 404, Internal Controls, and to a somewhat lesser extent, Section 302, Corporate Responsibility for Financial Reports.

## EFFECTIVE DATES OF THE ACT

Although the Act was signed into law on July 24, 2002, Congress in its infinite wisdom decided to give its corporate constituents a little leeway in complying with various requirements. In all fairness, many companies needed the delay in order to comply. While there have been several delays on some of the reporting requirements, the sections that affect accounts payable are now in effect with two exceptions

On September 21, 2005, the Securities and Exchange Commission (SEC) extended the compliance deadline for nonaccelerated filers to comply with the filing requirements under Section 404 of the Sarbanes-Oxley Act of 2002. Under this one-year extension, a company that is not required to file annual and quarterly reports on an accelerated basis (i.e., a nonaccelerated filer) now must first comply with the Section 404 requirements for its first fiscal year ending on or after July 15, 2007.

Also, a foreign private issuer that is an accelerated filer and that files annual reports on Form 20-F or Form 40-F must begin to comply with the internal control over financial reporting and related requirements in the annual report for its first fiscal year ending on or after July 15, 2006.

## WHISTLEBLOWER PROTECTIONS

The Act specifically prohibits retaliation against informants. It has two enforcement regimes—one civil and the other criminal—to protect people who report corporate fraud in their organizations. On the civil front, the employee has the right to reinstatement, back pay, and damages for whistleblowers. On a more serious note, the criminal provision makes it a felony to retaliate against a protected whistleblower.

And, it's not only corporations that are at risk if they retaliate against an employee who has informed. Individual managers can be charged with unlawful retaliation and face up to ten years in prison and a $250,000 fine.

Be that as it may, only the completely naïve would believe that there will be no retribution to an employee who chooses to go to the authorities to report what he or she perceives as wrongdoing at their firm.

## AUDITOR INDEPENDENCE: THE PROBLEM

Ask yourself this question: At your firm, where was the controller employed before he or she came to work at your company? At many organizations the answer to that question will be "our accounting firm." This was especially true before the legislation was passed. Similarly, if you look at other people on the accounting staff, you may find a surprisingly large percentage worked for your external auditor at some time in the past.

Ninety-nine percent of the time this does not cause a

problem. In fact, on some level, it is a benefit to the firm to be able to hire a qualified accountant who has some experience with its books. But, that other 1% of the time is problematic. A company that is in a position to hire an auditor at a much higher salary is in a position to sway that auditor's thinking. In fact, this can be so much the case that some refer to such auditors as *captives*.

That's the first way that auditor independence can be and is questioned. The second is more blatant and frankly even more troubling. Many auditors also offer other services. These services can be very lucrative. In fact, they can and often did add to the bottom line to a much greater extent than the traditional auditing services. As a matter of course, some auditors made so much more on the ancillary services that they began to offer their audit services at a lower price—the so-called loss leader.

This is where the lion's share of the perceived trouble with auditor independence, or lack thereof, lies. Companies that were granting consulting contracts and buying other profitable ancillary services from their auditors often held sway over the auditors when a disagreement over an accounting treatment arose. As was seen in a variety of headline-breaking cases, some auditors caved rather than risk losing their other bottom line–enhancing contracts.

The Act instituted guidelines on both the hiring and the ancillary services front.

## AUDITOR INDEPENDENCE: THE NEW REQUIREMENTS

Although there were all sorts of wild suggestions on the hiring front, the final regulations did not completely end the career paths for aspiring accountants who spent a few years honing their skills at public accounting firms. The final guidelines simply require that the CEO, controller, CFO, chief accounting officer, or person in an equivalent position cannot have

been employed by the company's audit firm during the one-year period preceding the audit.

Similarly, the Act did not want the top external auditors getting too chummy with their clients. To address this issue, it simply requires that the lead partner and the reviewing partner rotate off each account every five years. The accounting firms dodged a bullet on this issue as there had been talk of making companies switch audit firms periodically. As you might imagine, there was an uproar from the accounting firms on this issue.

However, on the ancillary services front, the Act took a hatchet to the accounting firms' bottom line. The list of what a registered public accounting firm may not provide to its audit client is extensive. Specifically, the firm cannot offer any nonaudit service to an issuer contemporaneously with the audit, including:

- Bookkeeping or other services related to the accounting records or financial statements of the audit client
- Financial information systems design and implementation
- Appraisal or valuation services, fairness opinions, or contribution-in-kind reports
- Actuarial services
- Internal audit outsourcing services
- Management functions or human resources
- Broker or dealer, investment adviser, or investment banking services
- Legal services and expert services unrelated to the audit
- Any other service that the board determines, by regulation, is impermissible

This does not mean that an accounting firm cannot offer any services outside of the audit. It may under certain limited

instances engage in any nonaudit service, including tax services, not listed above. However, this activity must be preapproved by the audit committee of the issuer and disclosed in the firm's financial statements.

Given what has gone on in the accounting world in the last few years, what public company in its right mind would knowingly open itself up for the criticism that would undoubtedly arise if it were to give its auditors large nonaudit contracts?

The preapproval is not required if the aggregate amount of all such nonaudit services provided to the company constitutes less than 5% of the total amount of revenues paid by that firm to its auditor.

## TIMELY DISCLOSURE

### Standard Filings

One of the goals of the Act is to get accurate financial information into the hands of investors as quickly as possible. The Act talks about getting the data to investors in real time. While this is not quite possible, the time frames for releasing financial statements have been reduced.

The Act requires "almost real time" disclosure. This means that each month, the pressure on accounts payable (as well as other functions within the company) to close quickly will intensify. Additionally, any unusual material events must be disclosed to investors quickly. For the most part, material events are unlikely to occur in accounts payable. The matter could get sticky if there were a large fraud.

### Material Events Affecting Investors

The goal of Section 409 is to protect investors from delayed reporting of material events, increasing their losses. Thus, if

something out of the ordinary occurs and it will negatively impact the financial statements, it must be reported quickly. Companies cannot wait until the end of the reporting period and report it with their quarterly results, known in the trade as 10-Qs (Form 10-Q), or annual results, referred to as 10-Ks (Form 10-K).

Public companies must disclose information on material changes in their financial condition or operations on a rapid and current basis.

While this infrequently affects accounts payable, on rare occasions it could. Should an unexpected event of significant financial size occur in accounts payable, the manager should bring it to the attention of the controller quickly. Some examples that come to mind include:

- A large fraud
- A large fine for failure to comply with unclaimed property laws combined with a requirement that the company turn over a significant amount of escheatable property
- A big increase in the price of a raw material that comprises a large portion of your production costs
- The loss of a preferred supplier and the replacement with a much higher priced provider

Clearly, these events are out of the ordinary. Equally as evident is the fact that if they have a significant impact on the bottom line, they must be disclosed. In the cases discussed, other parties (departments) are likely to be involved. In most instances, these other parties will be the ones responsible for the reporting. However, it would not hurt for the accounts payable professional to raise the issue of the reporting.

## HOW MATERIAL EVENTS ARE REPORTED

It should come as no surprise to you to learn that the SEC has a special form for companies to use when reporting material events. Form 8-K is used to report material events or corporate changes that have not been previously reported by a company in a quarterly report (Form 10-Q), or an annual report (Form 10-K).

Form 8-K is used to report material events or corporate changes that have not been previously reported by a company in a quarterly report (Form 10-Q) or an annual report (Form 10-K). Here's what must be reported on that Form:

- Changes in control of registrant
- Acquisition or disposal of assets
- Bankruptcy or receivership
- Changes in registrant's certifying accountant
- Other events and Regulation FD disclosures
- Resignation of registrant's directors
- Change in fiscal year
- Amendments to the registrant's code of ethics or waiver of a provision of the code of ethics
- Temporary suspension of trading under the registrant's employee benefit plans
- Entry into a material definitive agreement
- Termination of a material definitive agreement
- Creation of a direct financial obligation or an obligation under an off-balance-sheet arrangement of a registrant
- Triggering events that accelerate or increase a direct financial obligation or an obligation under an off-balance-sheet arrangement
- Costs associated with exit or disposal activities
- Material impairments

- Notice of delisting or failure to satisfy a continued listing rule or standard; transfer of listing
- Nonreliance on previously issued financial statements or a related audit report or completed interim review
- Unregistered sales of equity securities
- Material modification to rights of security holders
- Departure of directors or principal officers and appointment of principal officers
- Amendments to articles of incorporation or bylaws

This new expanded required reporting list became effective August 23, 2004.

## MANAGEMENT ASSESSMENT OF INTERNAL CONTROLS

This innocuous sounding section has sparked a revolution in many accounts payable departments around the country. The requirement is simply that annual financial reports must include an "Internal Control Report" that states that management is responsible for adequate internal control structure and an assessment by management of the effectiveness of the control structure. Shortcomings in the controls must also be reported.

Now, with the sword of Damocles hanging over management's head in the form of fines and jail time, it is not likely that they will simply sign off without a thorough and exhaustive review. And, in many cases, they are not signing off until they have their managers sign off on similar documents. It is not likely that these subcertifications will bind their signers in the same way that the CEO and CFO are bound if they certify fraudulent statements, but the end result will not be good if there are errors or worse.

Not only do the top executives have to sign off, but the external auditors must also attest to the accuracy of the com-

pany management's claim that the internal accounting controls are:

- In place
- Operational
- Effective

Specifically, the Act requires that the annual report contain an internal control report that:

- States the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting
- Contains an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting

It is important to note that these assessments are part of the annual report. It is these requirements, along with harsh penalties for fraud or misrepresentation, that have led some companies to require subcertifications from their managers responsible for internal controls at the operational levels.

## AUDITORS' ASSESSMENT OF INTERNAL CONTROLS

In the past, especially in a captive situation, the auditors might have been persuaded to sign off when in their hearts they believed something was amiss. Those days have ended. With the demise of one accounting firm and most of the other big ones facing lawsuits from disgruntled investors who relied on their work in the past, auditors are no longer caving to the demands of their corporate clients.

It should also be noted that the public accounting firm hired to audit the books and prepare the annual report must also make the internal control assessment. The audit and the

internal control assessment go hand in hand. They may not be separate. There is no passing the buck or finger pointing allowed here.

Specifically, the Act requires that the firm that prepares or issues the audit report shall attest to and report on the assessment made by the management of the firm it has audited.

The net result is that stringent internal controls are finally finding their way into the corners of most accounts payable departments.

## CORPORATE RESPONSIBILITY

The press has had a field day at the expense of companies whose top executives made (but clearly didn't earn) obscene amounts of money while claiming ignorance of the frauds and/or financial shenanigans engineered by their lieutenants. The Act has put an end to that irresponsibility.

Simply put, if you are the CEO or CFO, you are responsible.

The Act requires that the principal executive officer or officers and the principal financial officer or officers, or persons performing similar functions, certify in each annual or quarterly report filed that:

- The signing officer has reviewed the report.
- Based on the officer's knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading.
- Based on such officer's knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the issuer as of, and for, the periods presented in the report.

- The signing officers:
  - Are responsible for establishing and maintaining internal controls.
  - Have designed such internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared.
  - Have evaluated the effectiveness of the issuer's internal controls as of a date within 90 days prior to the report.
  - Have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date.
- The signing officers have disclosed to the issuer's auditors and the audit committee of the board of directors (or persons fulfilling the equivalent function):
  - All significant deficiencies in the design or operation of internal controls that could adversely affect the issuer's ability to record, process, summarize, and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls.
  - Any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls.
- The signing officers have indicated in the report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

You will notice that the Act leaves no wiggle room.

Of course, few top executives will willingly sign such a document without reasonable assurances from their staff that the

company has actually done what they are signing. And, to be perfectly fair about the whole thing, it is not unreasonable for them to ask for such assurances. Few CEOs and CFOs have the time, interest, or understanding to get down in the trenches and verify that the master vendor file-coding standards are being adhered to or that invoices are matched correctly against the purchase order and receiving documents or other accounts payable processes.

They therefore ask for verification of the appropriate controls from the managers responsible for those functions. Sometimes this is done informally, but, increasingly, they are asking for a signed document referred to as a *subcertification.*

## SUBCERTIFICATIONS

An outcome of the Act, which some see as necessary and others view as unreasonable, is the requirement in some organizations that middle managers, such as the accounts payable manager, certify that the work in their department is accurate and the internal controls within the operation are appropriate. Depending on the company and the corporate culture, the managers in question may be required to sign these documents or they may simply have the option to sign.

Even where signing is an option, we know of no organization that makes that fact clear to the managers in question. Rather, it comes to light when managers have balked at signing. In other cases, a manager who refuses to sign can be terminated. While it is readily apparent as to why management would want a certification from the line managers, it is not so clear as to whether this requirement is reasonable.

These subcertifications are also referred to as cascading certifications and upstream certifications.

## USING THE ACT TO FOSTER CHANGE

*Accounts Payable Now & Tomorrow* polled a group of readers to determine if Sarbanes-Oxley was instrumental in getting change implemented in accounts payable operations. Less than 20% indicated that the Act had no impact on their operations. Almost 30% said that it helped prove that their existing controls were effective. Approximately the same number said that because of the Act they added more controls and/or made changes that would benefit their programs. Just under 10% said that their processes were made more restrictive due to Sarbanes-Oxley, and close to 20% said that they were forced to document their policies and procedures because of the Act.

Throughout this book you will see references to using Sarbanes-Oxley as ammunition to force changes that are long overdue. But does it really work? When *Accounts Payable Now & Tomorrow* asked its readers if they were able to use Sarbanes-Oxley to obtain support within their organization to make desired changes, just under 30% said it was key. So, despite the extra work and hassle, you can see that some professionals have found ways to turn their Sarbanes-Oxley lemons into a positive outcome.

## DIRECTORS INSURANCE

More than a few companies have what's known as D&O (directors and officers) insurance. This is a policy that covers the directors and officers of the corporation. Some have added coverage for inadvertent noncompliance with Sarbanes-Oxley. (*Note:* Few cover outright fraud.)

If you have the title of Accounts Payable Director, do not assume you are covered. You are not. The directors referred to in this policy are the executives who sit on your company's board of directors.

This, of course, brings up the issue of whether it is fair to cover the top officers and directors while leaving the rank-and-file employees out there to dry if they sign a subcertification that turns out to be false.

## CONCLUDING THOUGHTS

The Sarbanes-Oxley Act provides a rigorous discipline that can be used by all organizations, regardless of whether they are publicly traded or not. Strong internal controls and segregation of duties should become a standard way of thinking rather than something required by law. In the end, everyone will come out a winner.

# 2

# Compliance Alternatives: Outsourcing and the COSO Framework

The bad publicity surrounding the accounting scandals that led to the passage of Sarbanes-Oxley raised the bar for internal control issues. While corporate America certainly had been aware of the issues, the new requirements meant these matters could no longer be addressed in only a handful of organizations. Everyone had to get on the bandwagon and they had to do it quickly. There was little time available to devote to developing elaborate new processes to address the matter. Within a short period of time, two old chestnuts emerged: outsourcing and the COSO Framework.

## OUTSOURCING

Now, let's get something straight. Outsourcing is not a solution to the ills identified by Sarbanes-Oxley. It should be selected as a processing alternative only when it makes financial and operational sense. The traditional reason for using out-

sourcing is so that companies can focus on their core competencies, leaving others to handle the processes that do not fall under that umbrella. In accounts payable, few companies outsource the entire process, although many outsource specialty functions, including:

- Check printing
- Duplicate and erroneous payment audits
- Unclaimed property administration
- Sales and use tax administration
- Travel and entertainment processing
- 1099 preparation

Initially, some may have thought that they could push off their compliance obligations by using a third party. That is simply not the case.

## SARBANES-OXLEY REQUIREMENTS IF USING AN OUTSOURCER

Under Sarbanes-Oxley, management is responsible for evaluating the design and effectiveness of the control structure in place both within the third-party provider and between the two organizations if an outsourcer is used and it directly impacts the financial reporting or internal control environment activities. So, you can see, the control requirements do not completely go away simply by outsourcing the function. Astute readers are probably already noticing that these requirements seem less strenuous than those outlined in the prior chapter. We will come back to that point further on in this chapter.

Practically speaking, companies that outsource now have to address two additional issues if they are to be Sarbanes-Oxley compliant. They are:

1. The determination of outsourcing with regard to impacting financial reporting
2. The identification of the most appropriate mechanism for demonstrating effective controls on outsourced functions

It should be noted that the first item is not as simple as it might first appear. For example, related-party transactions, such as the use of shared service centers, need to be fully addressed.

At first glance it might appear that in order to be in compliance you need to review the outsourcer's controls. But that did not turn out to be the case.

## MECHANISM FOR DEMONSTRATING APPROPRIATE CONTROLS

The Securities and Exchange Commission (SEC) stepped into the fray and provided a solution. After reviewing Section 404 requirements and interpreting them as they pertain to outsourced operations, the SEC provided a resolution. In June 2004 the SEC announced that companies relying on third-party service providers could rely on Type II SAS 70 reports to assess the internal controls in those operations.

Not only was SAS 70 designated as an acceptable method for assessing controls, it is the preferred method. With SAS 70 being held up as the gold standard for an outsourcer's confirmation of Sarbanes-Oxley compliance, it is now becoming the standard that all outsourcers must meet.

Readers should note that SAS 70 was around a long time before Sarbanes-Oxley. However, it grew in public stature once the SEC announced that it could be used to certify appropriate internal controls of an outsourcer.

There is one real advantage to this approach. Each company using a particular outsourcer does not have to complete

its own investigation and review of the outsourcer's internal controls. No individual assessment is required. All it has to do is ask the outsourcer for its SAS 70 report and it may rely on that.

**SAS 70 Synopsis**

The Statement on Auditing Standards for service organizations (SAS 70) was developed by the American Institute of Certified Public Accountants (AICPA). An SAS 70 audit (or *service auditor's examination,* as it is sometimes called) verifies that the control objectives and activities of the subject company are in place. At the end of the examination, assuming that the appropriate controls are in place, a formal report is issued to the service provider.

This SAS 70 report, often referred to as the *Service Auditor's Report,* is given to auditors at companies using the services of the outsourcer to permit them to certify the controls of their clients.

Basically, there are two types of reports, referred to as Type I and Type II.

**What a SAS 70 Report Is Not**

Throughout this chapter you will see references as to why many view SAS 70 as not as stringent as Sarbanes-Oxley. For starters, SAS 70 is not:

- A checklist audit
- A predetermined set of control objectives
- A predetermined set of control activities
- As rigorous as Section 404

**Type I Reports**

A Type I report includes:

- Independent Service Auditor's Report
- Service organization's description of controls

There are several optional features that may be included. They are:

- A description of the service auditor's test of operating effectiveness and the results of those tests. This information is provided by the independent service auditor.
- Other information as the service organization chooses to include.

This report describes the controls in place at a specific point in time.

In this report the service auditor will offer its opinion on whether the description of its controls presents fairly the relevant aspects of the organization's controls and whether the controls were designed appropriately to achieve the specified control objectives.

**Type II Reports**

A Type II report includes:

- Independent Service Auditor's Report
- Service organization's description of controls
- A description of the service auditor's test of operating effectiveness and the results of those tests. This information is provided by the independent service auditor

Other information as the service organization chooses to provide may also be included. It is this latter type of report that the SEC has deemed appropriate for companies using third-party service providers to rely on.

This report is not for a specified point in time but rather includes detailed testing of the service organization's controls over a minimum six-month period.

In addition to the items certified in the Type I report, the Type II reports include an opinion as to whether the controls tested were operating with sufficient effectiveness to provide reasonable assurance that control objectives were achieved during the specified period. The important feature to note here is the use of the word *reasonable*. The report does not guarantee that the control objectives have been achieved but rather that there is a reasonable certainty that the objectives have been achieved.

### Using SAS 70 Reports

Organizations that outsource parts of their business process should request SAS 70 Type II reports from the third-party service providers they rely on. Of course, this is required only after a determination has been made that the services directly impact financial reporting or internal control environment activities. However, it is probably a good idea to request these reports even if you are not required to comply with Sarbanes-Oxley. Why?

Ask for an SAS 70 Type II report to ensure that the organizations that are being used to handle outsourced functions are employing strong internal controls. You will get good information regarding the outsourcer's controls and effectiveness of those controls.

However, be aware that there have been some critics of the use of SAS 70 Reports.

### Problems with SAS 70 Reports

For starters, there is a timing issue. You may be relying on a report that is slightly out of date. Remember, the report covers only a six-month period. It is possible that the controls that were in place when the report was prepared are no longer in place or have slipped a bit. Even if one simple step

is omitted from a process, a loophole may be created that destroys the perfect control environment that had existed.

Again, the report is only attesting to reasonable controls; it does not guarantee that they are in place.

Some also question the level of detail that is revealed in these reports. The outsourcer is required to inform clients only of failures of SAS 70 tests but not the extent, substance, or scope of the audit. So, those relying on the report do not have all the details. They do not know the full extent of the audit, which would help them put the reports of failure in some perspective.

There is also the touchy issue of auditor independence and conflicts of interest. This can occur when the outsourcer's auditor is also the auditor of your company. With only four big firms, this is becoming a more common occurrence.

### What Can Be Done if You Must Rely on SAS 70 Reports

There are several things a company can do if it must rely on SAS 70. These are issues that should be raised when negotiating with the outsourcer initially. If you are under contract, it will be more difficult to get the outsourcer to agree to any of these strictures—unless they are already doing so for another client, in which case it will cost them little to include you in any additional reports. The issues that should be raised include the following:

- Request that your outsourcer move its SAS 70 audits to a quarterly basis or have updates done throughout the year. This could become a big issue given that companies must certify quarterly.
- Insist that the outsourcer disclose the scope of the audit. This will help you put any failures in proper perspective.

## COSO FRAMEWORK: BACKGROUND

Faced with the challenge of complying with Section 404, there was a mad scramble to find an approach that would meet all the requirements while not reinventing the wheel. It did not take long before people started talking about the COSO Framework. First published in 1992 by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) under the auspicious title of *Internal Controls—An Integrated Framework,* it seemed like an answer to nervous CFOs' prayers. And it was.

Designed to address some of the risk elements that were brought under harsh scrutiny by some of the derivative debacles of the late 1980s and early 1990s, the COSO Framework, as it came to be affectionately known, also addresses the concerns identified in Section 404 of the Act.

The original framework had five components. All had to be satisfied in order for internal controls to be deemed effective. They are:

1. Control Environment
2. Risk Assessment
3. Control Activities
4. Information and Communication
5. Monitoring

In 2004, the Commission updated the framework to address enterprise risk. The new COSO framework emphasizes the importance of identifying and managing risks across the enterprise. To accomplish this goal, three additional components were added:

6. Objective setting
7. Event identification
8. Risk response

## COSO OBJECTIVES: ENTERPRISE RISK

The framework breaks down risk for an organization into four broad categories:

1. **Strategic.** High-level goals
2. **Operations.** Effective and efficient use of the organization's resources
3. **Reporting.** Reliability of reporting
4. **Compliance.** Compliance with applicable laws and regulations

One of the phenomena observed since the passage of Sarbanes-Oxley is increased compliance with certain laws. The most flagrant example is unclaimed property. Prior to the passage, some companies simply ignored their obligations in this area. Ask 100 professionals if their firms kept uncashed checks and wrote the amounts off to miscellaneous income, and those admitting to this shoddy practice are probably in the double digits.

Today, with the requirement that senior executives certify that they are in compliance, few companies continue this practice. In fact, The National Association of Unclaimed Property Administrators reported that in 2003 there was a 44% increase in the amount collected by the states in 2000. It is unlikely that this is natural growth.

## ENTERPRISE RISK MANAGEMENT

### Definition

Enterprise risk management is:

- A process that is ongoing and flowing through an entity
- Effected by people at every level of an organization
- Applied in strategy setting

- Applied across the enterprise, at every level and unit, and includes taking an entity-level portfolio view of risk
- Designed to identify potential events that, if they occur, will affect the entity and to manage risk within its risk appetite
- Able to provide reasonable assurance to an entity's management and board of directors
- Geared to achievement of objectives in one or more separate but overlapping categories

**Components**

The components of the framework consist of:

- **Internal Environment.** The internal environment encompasses the tone of an organization and sets the basis for how risk is viewed and addressed by an entity's people, including risk management philosophy and risk appetite, integrity and ethical values, and the environment in which they operate.
- **Objective Setting.** Objectives must exist before management can identify potential events affecting their achievement. Enterprise risk management ensures that management has in place a process to set objectives and that the chosen objectives support and align with the entity's mission and are consistent with its risk appetite.
- **Event Identification.** Internal and external events affecting achievement of an entity's objectives must be identified, distinguishing between risks and opportunities.

Opportunities are channeled back to management's strategy or objective-setting processes.

- **Risk Assessment.** Risks are analyzed, considering likelihood and impact, as a basis for determining how they

should be managed. Risks are assessed on an inherent and a residual basis.

- **Risk Response.** Management selects risk responses—avoiding, accepting, reducing, or sharing risk—developing a set of actions to align risks with the entity's risk tolerances and risk appetite.
- **Control Activities.** Policies and procedures are established and implemented to help ensure that risk responses are effectively carried out.
- **Information and Communication.** Relevant information is identified, captured, and communicated in a form and time frame that enable people to carry out their responsibilities. Effective communication also occurs in a broader sense, flowing down, across, and up the entity.
- **Monitoring.** The entirety of enterprise risk management is monitored and modifications made as necessary. Monitoring is accomplished through ongoing management activities, separate evaluations, or both.

For additional information about the COSO Framework refer to its Web site at *www.coso.org*.

## CONCLUDING THOUGHTS

Luckily, the COSO Framework was around and gave those organizations looking for a place to start an easy starting point. Of course, those institutions already taking advantage of the discipline it offers were well ahead of the game with their Sarbanes-Oxley requirements.

# 3

# Invoice Processing

At the head of all accounts payable operations is the invoice-processing function. In fact, given the diversity of the functions handled in accounts payable departments, some experts maintain that the only constant across all thresholds is invoice-processing responsibility.

Roughly speaking, invoices can be broken down into two categories:

1. Those requiring a purchase order
2. Those without a purchase order

The purchase order is the first line of defense (as well as the first place where controls can start to go astray) in the invoice-processing function.

## PURCHASE ORDERS

As the title implies, purchase orders (POs) are forms, usually filled out in purchasing, that detail the parameters of a purchase transaction. They are usually sent to the supplier, and in an ideal situation, a copy is also sent to accounts payable.

In today's electronic environment, these forms can be transmitted electronically and/or filled in on an online database. In such cases accounts payable can and should have access.

As indicated, the PO can either be the first line of defense or the first place where internal controls start to break down. Here are a few of the issues:

- How accurate is the information on the form?
- Is the form completely filled out?
- Are special deals documented on the PO?
- Is the PO filled out before the transaction is consummated or after the fact?
- When is the PO sent to accounts payable?

An invoice that is accurate, complete, and timely guards against an improper payment. An improper payment might be an incorrect amount, a payment to the wrong party, or, even worse, a payment to a supplier who never delivered goods or services. Finally, there is the issue of payments for shoddy goods never ordered but delivered—a petty fraud that is ongoing (usually of copier toner, paper, or yellow pages ads).

The PO is one of the three key documents used to verify an invoice for payment. As those who work in accounts payable are well aware, the proverbial three-way match is used in most organizations. It matches the PO against the receiving documents and the invoice submitted for payment. When all three match, the invoice is processed and a payment scheduled. If there is no match, discrepancies must then be resolved.

## PURCHASE ORDER PROBLEMS

Most PO problems signify a breakdown in internal controls. Accounts payable professionals who have problems getting

some of these issues addressed can now use the threat of noncompliance with the Sarbanes-Oxley Act to harness management support for their initiatives. Specifically, and at a minimum, POs should:

- Be completely filled out (a big problem in some organizations)
- Be sent to accounts payable (or accounts payable should have online access)
- Not be done after the fact

If the PO does not have all the information included, it is difficult if not impossible to complete the three-way match. Companies that require this matching (and that is most of them) will sometimes end up without an invoice. When alerted to this fact, the purchasing professional will sometimes create one. This is really adding work without adding value. However, it often is necessary within the confines of the operating policy of the organization—and is a complete breakdown in internal controls. It is also a prime example of how special terms can get lost—because they are never reported to accounts payable, and the vendor, either intentionally or by mistake, has created the invoice using the standard terms rather than the special terms negotiated. Thus, the hard work the purchasing professional put in getting the improved terms was for naught.

### Purchase Orders for Everything

Some organizations require a PO for every payment that is made. Others require them for every material purchase made. This approach can be use to subtly pressure employees to use payment mechanisms (e.g., purchasing cards [p-cards] and reimbursements through travel and entertainment [T&E] reports) that do not require a PO.

**Non–Purchase Order Invoices**

Purchase orders are a great internal control. However, not every purchase lends itself to the purchase order methodology. When an invoice shows up that has no PO related to it, the internal controls are weakened. However, non-PO invoices are a fact of life for many organizations. Typically, they are marked, "Okay to Pay," and signed by an employee authorized to approve purchases. Sometimes these invoices are attached to a check request form and sometimes they are not.

As you can imagine, the controls on such purchases are weaker than the controls associated with a PO. Additional problems, especially with low-dollar non-PO invoices include:

- No real verification of the product received
- No verification of whether the produce was ordered, meets standards, and so forth
- No real verification as to whether this is a duplicate invoice

**No Invoice Number**

Many non-PO invoices, as well as some invoices associated with POs, have no invoice number. While to the uninitiated this may seem like a minor issue, it can create huge control issues. In fact, invoices without invoice numbers is one of the leading causes of duplicate payments. The reason for this is that in many organizations the controlling feature on determining if a payment has been made is the invoice number.

Without that feature, the controls go out the window unless a strict numbering standard has been established to issue invoice numbers to these invoices. (For more information on this issue, see Mary Schaeffer, *Accounts Payable Best Practices,* [John Wiley & Sons, 2004].)

## DOCUMENTATION

You will read in various chapters in this book about the need for a policies and procedures manual. Typically, these are held in each department. The PO issue straddles at least two department lines, which is one of the reasons why there is sometimes trouble. To satisfy Sarbanes-Oxley, good documentation of policies and procedures is essential.

Thus, it is suggested that accounts payable and purchasing work together on the project of documenting PO requirements and the communication between the two departments over what's on the PO and how that information is disseminated to accounts payable. What formerly may have been a territorial issue can no longer be that. Information must be shared and petty interdepartmental issues must be put aside. A comprehensive set of procedural instructions will go a long way in ensuring that:

- Accurate information is shared on a timely basis.
- Only payments that are supposed to be made are made.
- Each department knows what it is required to do.

Oh, yes, and good documentation is a giant step in the right direction of Sarbanes-Oxley compliance.

## FLOWCHARTS

Another requirement under Sarbanes-Oxley is that all processes must be flowcharted. Just as the documentation related to POs should be completed with input from, or in conjunction with, the purchasing department, the part of the accounts payable department's flowchart that refers to the receipt of POs should be completed with similar input. One of the benefits of these flowcharts is that they sometimes make it possible to easily identify non-value-added steps in the process that can be very easily eliminated from the equation.

See Chapter 12 for a more in-depth discussion of the flowcharting requirements.

## INVOICE HANDLING: CLEAR INSTRUCTIONS

While the accounts payable department has a fairly good idea of who originates POs and who to contact to strengthen weak controls, the matter is much more difficult when it comes to invoices. For starters, virtually every one is initiated by a party outside the company's direct control. While the accounts payable department can try and lay down rules for these parties, it has little control. However, it does have strong influence in that by providing clear and accurate instructions to vendors it can hasten payments to those who conform to its guidelines.

Thus, the first step to getting invoices sent in correctly is to provide vendors with clear instructions on where invoices should be sent. This is a bigger issue than it might appear at first glance. For starters, the company needs to have a policy regarding where invoices should be sent. This breaks down into two possibilities:

1. Directly to accounts payable
2. To the individual who authorized the purchase

These are virtually the only two choices, and there appears to be no right way. Companies vary on what they require. Some want everything sent to accounts payable, where it may be scanned before being sent out for approval. Others require that the invoice be sent to accounts payable only after it has been approved for payment. Which way is better? There is no clear answer, as both methodologies have problems associated with them.

However, even though most experts recommend that invoices be directed to someone's attention, many come in addressed to no one and float through the company, eventually

ending up in accounts payable. No wonder vendors don't get paid on time! Even when the mailroom is told to forward anything that looks like an invoice to accounts payable, invoices float.

A decision regarding where invoices should be sent must be made within each company. Once that decision has been made, this information needs to be communicated to all vendors. It should be included in the welcome package that is sent to new vendors. It can also be communicated through regular communication that purchasing has with suppliers. However, on the vendor's side, this information needs to be transferred from the sales staff to the professionals responsible for billing. If there appears to be a breakdown in communication on this issue at the supplier (and some salespeople have little interest in the billing side of things), accounts payable can take the lead and communicate this to the person responsible for billing.

There is also an issue when invoices arrive in accounts payable with no indication as to who ordered the items covered by the invoice. Some companies, usually the lead players in an industry, require that either the name of the person ordering the goods or the PO number be included on the invoice. Without these vital pieces of information, accounts payable may be clueless as to where to go to get the invoice approved for payment—a very necessary part of the payment process.

When *Accounts Payable Now & Tomorrow* polled a group of its readers, almost 15% indicated that they were able to improve their invoice-handling process because of the Sarbanes-Oxley Act.

## APPROVAL PROCESS

### Delegations

Typically, in a well-run company, the board of directors delegates the authority for various functions through resolutions.

This authority can then be subdelegated. Thus, the board might delegate purchasing authority at various dollar levels to several high-level executives, typically by title (not name). These executives then subdelegate to their appropriate staff.

All this information should be written down and updated whenever there is a change. This information should be given to the accounts payable department. It should also contain signature specimens similar to those obtained for signature cards for the banks. This is sensitive information and should be kept in a secure location, not lying around where anyone passing by might see it. Similarly, whenever the information is updated, old copies should be destroyed.

It is important to remember that there is a difference between the person who submits something for payment and the person who approves that payment. The number of people who can submit for payment will be much higher than those who can approve. It is an internal control feature to have at least two sets of eyes view every purchase. No one should approve payments for items they have purchased.

Clearly, the number of people who can authorize a payment will be limited, even at large companies. This delegation is also limited by dollar levels. Thus, a $100 purchase may be approved by a supervisor, while a $100,000 purchase might require the authorization of a vice president.

### Getting the Approval

If there is one area that causes accounts payable more headaches, it is the invoice-approval process. Some of the most egregious examples of how accounts payable and purchasing don't get along revolve around the invoice-approval process. Here's how the scenario plays out when things are not going well: Accounts payable sends an invoice to purchasing for approval. The purchasing professional has many things to do and low on his list of priorities is checking that

invoice and approving it for payment. Until it is approved and returned, accounts payable can't do anything. So it sits for weeks in purchasing getting buried deeper each day as more paper is dumped into the in-box.

Then the vendor calls looking for its payment. The purchasing guy, who wants to be the good guy and is unlikely to admit that he's been sitting on the invoice, tells the vendor to call accounts payable, that he sent it back to them weeks ago. It's a quick way to get rid of an angry vendor. He then quickly finds the invoice, signs off on it (without checking it!), puts it in an interoffice envelope marked accounts payable, and forgets about the whole mess. Now, when the vendors call accounts payable, they are under the impression that their invoices have been there for weeks, so these conversations tend to be a tad on the touchy side.

In the ideal scenario, accounts payable sends the invoice to purchasing for approval (or does not receive it until it has been approved), and purchasing approves it and returns it to accounts payable within 24 hours for processing for payment.

When an invoice is not paid by the end of the billing cycle (typically once a month), a follow-up invoice is sent. While this may be marked COPY or DUPLICATE INVOICE, they are not always so marked. Many of these second invoices get paid, often before the original invoice winds its way back to accounts payable. What do you think happens when that original turns up in accounts payable, approved for payment? If you answered that it sometimes gets paid, you are correct. Getting that duplicate payment returned can be a tedious and expensive proposition.

Clearly, paying an invoice twice indicates a breakdown in internal controls. To address this issue, most companies run some sort of duplicate payment–checking program to try and identify these payments before the money goes out the door. The programs have varying degrees of success, often depend-

ing on the level of controls in other parts of the accounts payable process.

The procedures for getting invoices approved, including the recommended time frames for each step, should be documented as part of the policy and procedures manual. They should also be flowcharted as part of that exercise.

Electronic processes have addressed many of these problems. See the Electronic Invoicing section for a discussion on this issue.

## THREE-WAY MATCH

As mentioned earlier, the three-way match is a strong control feature used at most corporations. If the PO, receiving document, and approved invoice match, the item is scheduled for payment. However, frequently, the three do not match and then the fun begins. It is also where the most well-intentioned internal controls can start to fall apart. Discrepancies can and should be investigated by the party in the best position to resolve them. That is rarely accounts payable, yet this is often where the responsibility for dispute resolution lies.

Strong dispute resolution mechanisms and policies should be developed. This is an area that is often lacking—and, once again, Sarbanes-Oxley may provide the necessary ammunition to get the much-needed management attention and support to the issue. Some of the electronic invoicing modules currently on the market incorporate an online dispute resolution mechanism that is extremely helpful.

Discrepancies in the three-way match process can be tracked by vendor and approver to identify potential weak links in the PO and approval process. Once it becomes clear that there is an issue with a particular vendor or purchaser, steps can be taken to eliminate the root cause of the problem. Sometimes all that is needed is a little education.

When *Accounts Payable Now & Tomorrow* polled a group of

its readers, 14% indicated that they had improved their invoice-matching process because of the Sarbanes-Oxley Act.

## SMALL-DOLLAR INVOICES

Small-dollar invoices are the bane of many accounts payable departments. They take a considerable amount of time and energy to process, taking precious time from larger transactions that deserve more scrutiny. Thus, many companies encourage the use of p-cards for small-dollar transactions. Others have developed mechanisms to review these invoices in a manner that utilizes fewer precious resources. One example is negative assurance. Approvers are notified of an invoice but not required to take any action unless they did not order the goods in question, hence the negative connotation in the nomenclature.

While these approaches are probably good from a work flow standpoint, they do open the door for potential small-dollar fraud, if care is not taken. Thus, while it makes sense from an operational standpoint to implement these processes, extreme care must be taken to ensure that the appropriate controls are put in at the same time. Otherwise, the fraudsters will quickly hone in on your weak links.

## CONTRACT COMPLIANCE

As companies everywhere look for ways to cut costs and improve efficiency, one area that continues to offer potential for some real bottom-line enhancements is the area of contract compliance. This is especially true of organizations that have large, complicated contracts involving many different items. The obvious example that springs to mind is a hospital that orders many different types of suppliers and different drugs. The opportunities for volume discounts are numerous.

Often, these contracts go on for pages, and rarely are in-

voices checked against contracts to make sure that all the terms of the contract are taken advantage of. It will come as no surprise to most reading this to learn that the more complicated the contract, the less likely it is that a company will adhere to it even most of the time. In fact, there are organizations whose business offering is simply going through contracts and payments, finding discrepancies, and then recovering those overpayments.

Again, the goal in this arena is to identify those potential overpayment situations before the funds are disbursed. A few companies have set up contract compliance groups, most often as part of purchasing, but occasionally under the accounts payable umbrella. This group is charged with making sure that the invoices paid comply with the signed contract. On the face of it, this may seem like a fairly straightforward process. Going back to the hospital example, it is easy to see how prices, especially in heavily negotiated supplies, could be misquoted. Equally important are the terms and any potential penalties and, as mentioned elsewhere in this chapter, special deals that are arranged outside the master contract.

Contract compliance reviews go hand in hand with strong internal controls and good documentation. For most companies, this is a relatively untapped arena that offers one of the last few footholds for professionals to find cost savings for their firms. To be done correctly, this needs to be one or more individuals' prime responsibility—not something to be handled off the side of their desks in the slow time (whenever that may be in accounts payable!).

## FRAUD

It is no longer acceptable, if it ever was, to permit a low level of fraud as a "cost of doing business." Any time fraud is uncovered, in all likelihood, you will also discover a weak link—an area where internal controls need to be adjusted. Documenta-

tion and flowcharting will help you zero in on those areas. In accounts payable, you are likely to run into three types of fraud:

1. Check fraud
2. Employee fraud
3. Supplier fraud

Check fraud will be discussed in Chapter 4, where all check issues are thoroughly evaluated. Supplier fraud typically involves an unscrupulous vendor sending in invoices for goods never ordered. This is small-time stuff and can be caught and eliminated fairly easily, with diligence. Existing vendor fraud is another matter.

Vendor fraud involves a vendor's overbilling or undershipping or perhaps also billing for goods never ordered. This is not to say that every overbilling situation involves fraud. In fact, in most organizations that will rarely be the case. This is just one of the reasons that it is often hard to discern when it's going on.

Another nasty factor associated with vendor fraud is that sometimes there is collusion with an employee, thus the emphasis—with or without Sarbanes-Oxley—on segregation of duties. If the company has a contract compliance group, there is a better chance that the fraud will be uncovered.

Conniving employees have been known to manipulate files, submit phony invoices, and make use of inactive vendors in the master vendor file in order to bilk their companies out of millions of dollars. Strong internal controls, sound accounts payable practices, and segregation of duties all play a role in minimizing the risk of employee invoice fraud. See Chapter 7 for a discussion of employee fraud via the T&E reimbursement process.

## SEGREGATION OF DUTIES

One of the more basic ways that fraud occurs in any organization is not having the appropriate checks and balances in

place. In accounts payable this is an important component of strong internal controls. There are certain functions that need to be segregated. For example, a person who can enter an invoice for payment should not also be able to set up a new vendor in the master vendor file or make changes to that file.

As a general rule of thumb, no employee, regardless of title or rank, should be able to handle two functions such that he or she would be in a position to defraud the organization through a manipulation of those responsibilities. For example, authorized check signers should not be able to issue and/or print checks. Appendix B contains a list of responsibilities that might be construed as inappropriate segregation of duties.

While a lot of this may seem like common sense, it can cause problems in small departments. In some instances it will not be possible to segregate duties appropriately without involving employees from another department, and that is what should be considered.

Even departments that can adequately segregate duties sometimes run into trouble when employees take vacation or are unexpectedly absent. Thus, it is a good idea to perhaps work with another group in smaller organizations.

Finally, even where it appears there is adequate staff to segregate duties, there can be problems. If there is just enough staff, problems can arise when:

- There is a natural disaster.
- The backup staff is out in combination with a planned absence.
- One or more employees leave the company.
- There are planned staff reductions (because management rarely thinks about the effects on the segregation of duties when reductions are mandated).

## MASTER VENDOR FILE

The master vendor file is the repository of all significant information about the company's suppliers. It is the reference point for accounts payable when it comes to paying invoices—and handled incorrectly, it can (and does) lead to massive problems. Fraud and duplicate payments are just the tip of the iceberg. While a company may have been willing to live with those risks in the past, it risks getting a negative assessment in its Sarbanes-Oxley audit if it continues to employ poor practices with regard to its master vendor files.

At a minimum, to have any chance of not being dinged when its master vendor file practices are reviewed, a company should:

- Limit access to the master vendor file.
- Periodically disable inactive vendors in the file (but do not delete the entries, as the payment history associated with that vendor needs to be retained).
- Establish a naming convention to be used when setting up vendors initially.
- Require that certain information (e.g., W-9s) be obtained before the vendor can be set up and/or paid.
- Have a senior-level review (yes, I know it is boring work) of all changes made to the file.

The reason for the last requirement is that thieving employees have been known to go into the master vendor file to change the mailing address to divert a legitimate payment from the vendor to an unintended party, usually themselves. Then, once the check has been mailed, they go back into the file and change the address back to the correct mailing address. Without the review of the changes, the fraud could go on undetected for years, with different vendors being targeted each time.

When *Accounts Payable Now & Tomorrow* polled a group of

its readers, almost 30% indicated that they had improved their controls surrounding their master vendor file processes because of the Sarbanes-Oxley Act.

**ELECTRONIC INVOICING**

Many of the problems facing the accounts payable function can be addressed through the use of electronic invoicing. For starters, the blame game that typically surrounds who got the invoice when, dissipates in the face of electronic work flow systems which not only leave an audit trail for everyone to see but also often include an automatic escalation to the approver's boss should he or she be on vacation—or simply be neglectful of the responsibilities related to checking and approving invoices for payment.

Similarly, there can be no dispute over who received an invoice and the timing of that receipt. Likewise, the electronic feature lets accounts payable forward the invoice for approval without having to rely on the often dubious interoffice mail facilities. This also relieves them of the onerous task of making copies before the invoice is forwarded and then having to dig through that file to determine what's been returned, where the invoice is in the approval chain, how long it's been out there, what needs to be followed up on, and so on. All these tasks add no value and, even worse, zap departmental productivity.

As you have probably figured out, the process described does not demonstrate anything remotely resembling strong internal controls and, worse, is an invitation to fraud and duplicate payments. The process is not conducive to timely reporting and getting the books closed at month end, and the end of the fiscal year can be a real challenge as more accruals than should be necessary have to be prepared. The accountants reading this will point out that it is much better to record an invoice on the books than to try and accrue for it.

**Models**

Very roughly speaking, electronic invoicing models break down into three categories:

1. Simple Email
2. Third-party models
3. Proprietary models developed by a company for its own use

The Email models are generally quite simple. An invoice is created, perhaps in Word or Excel, and is attached to an Email and sent to the accounts payable department for processing. Sometimes these documents are converted to a PDF file before they are sent. While this greatly improves the timeliness of the process and improves the likelihood that early payment discounts can be legitimately taken, there are some flaws in the process, mainly from a control standpoint. Still, there are some real benefits.

The third-party models incorporate a number of control features that may be missing in the home-grown Email approaches that many use. However, they can be (but are not necessarily) expensive, thus making it difficult for some managers to get the authorization to begin using them. And, depending on the features in the model and whether the process is actually outsourced, there can be SAS 70 concerns. This issue is addressed later in the SAS 70 section.

The proprietary models may be wonderful for the company that creates them, usually the purchaser, but are often a nightmare for the accounts payable departments that have to work with them. The reason for this is actually quite simple. When a company develops a model, often at considerable expense, it incorporates features that meet its own requirements. Often, these are unique and might actually reflect the corporate culture.

And you guessed it: It is unlikely that two companies devel-

oping two models separately will come up with the same approach. Even if they are similar, there will be variances. Think about this from a hypothetical accounts payable professional's point of view. If 20 of the suppliers that the company buys from have developed their own electronic invoicing models, that's 20 different systems the payables professional will have to learn.

If you are thinking that no two invoices are the same and this should not create a problem, you need to know that many of the buyer-centric models (described in the following Frameworks section) require that the customer go to their Web sites to "pick up" their invoices. Each will require a unique password and user ID, sometimes related to the customer number that the vendor has assigned to the purchaser. It can get onerous for the payables operation. If the supplier "delivers" the invoices to the payables in-box, some but not all of the problems go away.

**Frameworks**

Additionally, these electronic invoicing models can utilize one of three types of framework:

1. Buyer-centric
2. Seller-centric
3. Consolidator

While the consolidator model might be the approach that is considered most equitable to both the buyer and the seller, and the purchaser would prefer to have a buyer (payer)-centric model, the most common models are seller-centric. The reason for that is simple. The seller is the party that, with very few exceptions, initiates the invoice and has access to the information that will be used (sometimes to the payer's distress) to create the invoice. Hence, the seller models have been emerging, not

necessarily as the best practice model but from a practical standpoint, as the framework used most frequently.

### Evaluation

If it seems like we don't think electronic invoicing is a good thing, we gave you the wrong impression. We think the advantages far outweigh some of the smaller problems they may create. The huge advantage in the electronic invoicing world is the models that come with an online dispute–resolution mechanism. This allows for discrepancies to be adjudicated in a timely manner and for payment to be made in an equitable time frame.

While I recognize that a small number of companies use disputes to "legitimatize" their poor payment practices, from a Sarbanes-Oxley and an internal controls standpoint, it is not a good practice. By leaving invoices unpaid for long periods of time the odds of fraud and duplicate payment increase. Additional accruals may need to be done which do not enhance the timely reporting and disclosure requirements.

When *Accounts Payable Now & Tomorrow* polled a group of its readers, approximately 30% indicated that they had improved their electronic invoice processes because of the Sarbanes-Oxley Act.

### SAS 70

Some of the electronic invoicing models are actually outsourced solutions. An end user's ability to assess the adequacy of internal controls under these circumstances is limited. Thus, the SAS 70 requirement kicks in. For a more detailed explanation of SAS 70, refer back to Chapter 2.

It is a good idea for companies considering using an outsourced E-invoicing solution to ask for the SAS 70 as part of its initial evaluation or request for proposal (RFP) process. In

this way, any company that is not able to provide an acceptable report is eliminated from consideration, and future problems are averted.

## MONTH-END CLOSE

As mentioned earlier, in the ideal environment, there would be no accruals done at the end of the month. Of course, in the real world that is unlikely to happen, no matter how good a company's processes are. One of the requirements of Sarbanes-Oxley is timely disclosure. While the time frames for certain disclosures have been spelled out, most that relate to accounts payable have not been so delineated.

That does not mean that there are no requirements. Information from accounts payable flows up into the bigger picture. The requirements for the issuance of financial statements are tight and cannot be met if individual reporting units, such as accounts payable, do not close their books on a timely basis.

In addition to the timeliness issue is the question of internal controls in the invoicing process. If the process of closing the books drags out, it can be a reflection of the adequacy of the internal controls—and not a positive one.

## YEAR-END CLOSE

Everything that applies to the month-end close is applicable to the year-end close in spades. Timely reporting and strong internal controls come into play. The year-end close may also have an ugly subcertification requirement associated with it. Thus, it is important that the professional who signs the document ensure that not only is the work done, but the internal controls are adequate.

## RECOMMENDED INVOICE-PROCESSING PRACTICES

To ensure the fewest control issues in your invoice-handling practices, use the following practices:

- Prenumber and account for all purchase orders.
- Match invoices and receiving and purchase order information, and follow up on missing or inconsistent information.
- Record invoices accurately on a timely basis for all accepted purchases that have been authorized.
- Restrict ability to modify data.
- Reconcile vendor statements.
- Implement standards to guard against inaccurate input of data.
- Follow up on unmatched open purchase orders, receiving reports, and invoices and resolve missing, duplicate, or unmatched items, by individuals independent of purchasing and receiving functions.
- Have a focus for action/control activities.
- Uncover and take action quickly on invalid payments fraudulently created for unauthorized or nonexistent purchases.

## CONCLUDING THOUGHTS

The invoice is where the payment process is activated. It is therefore crucial that appropriate controls are incorporated at this stage. Otherwise, the door to fraud and duplicate payments is opened. Additionally, when thinking about segregation of duties as it relates to the payment process, it is imperative that the invoice-handling phase be included in that equation. Otherwise, true segregation of duties may not be achieved.

# PART II

## Payment Process

# 4

# Checks

When most people think about accounts payable, checks immediately come to mind. It is also the area in accounts payable that may be most vulnerable to weak controls. Much of this will depend on the corporate culture of an organization. Depending on the size of the organization, segregation of duties can also be an issue when it comes to check-related activities. For example, did you know that the person who handles the bank account reconciliation function should not be involved in unclaimed property reporting?

If you are scratching your head over that one, the explanation is relatively straightforward. The person who reconciles the bank accounts could indicate on the bank reconciliation reports that an item had been escheated (turned over to the state). In reality, he simply reissued the check to a friend or himself. This example demonstrates just how easy it can be for a dishonest individual knowledgeable about a company's inner workings.

## AUTHORIZED SIGNERS AND BOARD DELEGATIONS

The authority to sign checks typically is set by the board of directors. This generally indicates who, by title, can sign and to

what dollar limits. This authorization can typically be subdelegated, and in most cases the board authorization will indicate whether the signer can delegate further.

The board authorizations should also indicate whether one or two signatures are required on each check, at what levels a second signature is required, if a facsimile signature may be used, and so on.

## CHECK SIGNERS

In some companies, every executive over a certain level, say vice president, will be made an authorized signer on all bank accounts. This is viewed as a perk of the position, kind of an honorary thing. It is also a terrible practice from an internal control standpoint, although this is a battle that most accounts payable managers are loath to start.

To ensure accuracy, accounts payable should keep a list of authorized signers by bank account. This list is often the same one that lists all the company's bank account numbers. Many times, the signers are the same on all accounts, so only one list is maintained. There are several control points that surround this issue. Before adding anyone to the list, some analysis should be given to the consideration of whether the organization gains anything by adding this individual. Will he or she really be available to sign in cases of emergency, or is that just wishful thinking or an excuse to add an executive who thinks he or she should be on the list? Clearly, this is an issue that the accounts payable manager needs to address gingerly.

## DOCUMENTATION: CHECK SIGNERS AND ACCOUNTS

First, the report with all the sensitive information should have a limited distribution. This is a need-to-know report, not one that should be distributed to everyone who might have a passing interest in the data. Again, just because someone is a vice

president does not mean that they need this information. If the individual is not going to be writing or signing checks, then they probably do not need to be on the distribution list for this report. While this may sound harsh, it is in the company's best interest.

The list should be kept in a concealed location, not out on the desk of a clerk where anyone passing by can see it. In the evening, it should not be left out on a desk, even in an office, where someone on the cleaning staff could see it.

As mentioned, the distribution of the report should be limited, and whoever is responsible for generating it should keep a list of who received the report. It's a good control point to mark the report with a statement asking that it not be copied. All the controls fly out the window if one of the recipients takes the report and makes copies for people specifically excluded from receiving the report. Don, the vice president of research and development, does not need to know that the controller is one of the backup signers.

Whenever a new report is generated, the old reports should be returned and destroyed. While you can ask the recipients to destroy their copies, a super-careful manager would get the reports back and destroy them himself.

The list needs to be updated every time there is a change, including when an employee who is an authorized signer leaves the firm. At that point, anyone with any responsibility for getting checks as well as the banks should be notified that the employee has left. This is an area that is often overlooked. This control is especially important if the employee in question was terminated or left disgruntled. Often, notifying the bank and accounts payable is last on the list of things that anyone thinks about. It is crucial in those organizations that insist on putting every Tom, Dick, and Harry on the authorized signer list.

One last control point when it comes to check signers: If an employee who is also an authorized signer departs under

unpleasant circumstances, the organization might want to consider closing all bank accounts on which that person was a signer. Yes, it's an expensive option but the losses that might occur with check fraud could far outweigh the cost, especially if blank laser stock is used. If the company is still using expensive preprinted check stock, this could be a costly and time-consuming solution.

## CHECK STOCK

### Laser versus Preprinted

Handled incorrectly, an organization's check stock can open the door to fraud. If the stock is managed in a prudent manner, the risk is reduced. Readers are probably aware that even if they do everything correctly, they still stand a good chance of being hit with fraudulent checks. The first matter to be decided is what kind of check stock should be used. This is probably the first control issue related to the check itself. In the business environment, paper checks come in two varieties: preprinted and laser stock.

Most everyone is familiar with preprinted checks. They come with the vital information already printed on them. They are also prenumbered. Ideally, they incorporate some security features to make fraud a little more difficult. They require a good deal of management because in the hands of the wrong individual, they can be lethal. Corporations with numerous subsidiaries, each having their own bank account, can have a massive storage and control issue on their hands if they use preprinted check stock. Still, many organizations and virtually all individuals use preprinted check stock.

Laser checks, however, have none of the vital information preprinted on them. Before printing, they are simply a piece of paper. While in theory a company using a laser check-printing approach could use blank typing paper, this is not recom-

mended, and few, if any, do. Rather, laser checks, although printed by a regular laser printer, are printed on special safety paper, which is often numbered. This numbering is not to be confused with the check number. It is a control feature on the back of the item and is used by the organization in question to control its stock. Since the vital information is printed on the check at the time the check is printed, an organization with numerous entities does not need to purchase separate check stock for each one. Similarly, when an account is closed, there is no stock to be destroyed.

Let me make one thing clear: While there are many advantages from a business standpoint to laser checks, using preprinted check stock does not mean an organization has poor internal controls and is therefore not in compliance with Sarbanes-Oxley. What it does mean, however, is that organizations that use preprinted check stock will have to exercise a far higher number of internal controls in order to be in compliance with the Act.

**Security Features**

Controls on the check process start with the safety or security features built into the check itself. There are many different features (see Appendix C for a list of security features currently available) that an organization can incorporate into its check. It is not necessary to incorporate all of them to be considered to have decent internal controls in the check stock itself. However, you should have more than one or two.

Here's something you can do that will actually be a little fun. Take your personal checks provided you by your bank and compare them to Appendix C, which delineates security features. How many does your bank choose to have incorporated into your checks?

Here's one last note about security features. Sometimes, in an effort to cut costs, organizations will order their checks

from a company that offers an inexpensive product. A check's a check, goes the rationalization. While I don't recommend spending any more than necessary, don't cut your costs at the expense of security.

### Storage

Do you keep the spare checkbooks for your organization's bank accounts in your desk drawer or in an unlocked filing cabinet in the departmental work area? If you do, you have a bit of company, so don't feel bad on that count. However, if your auditors uncover this during their audits, they will ding you on the internal control issue. Before you dismiss this issue as something that would not happen under your watch, think about the checkbook you use to reimburse petty cash and the one used to write quick checks to employees who are terminated. Where are they kept in your organization?

Check stock should be kept under lock and key with extremely limited access. This is another example of where all the executives in the department do *not* need a key to the check-storage area. The more people who have access to the location, the less secure it actually is. Some organizations limit that access to two individuals. Those individuals should not leave the key to the storage area in their desks so someone else can get in should they be absent. This policy effectively undoes the internal control structure.

When it comes to segregation of duties, anyone who is a check signer should not also have access to the check-storage area. In most organizations the responsibility for the check stock area lies with a middle manager.

## CHECK-SIGNING PROCEDURES

If you take a look at the checks signed by most organizations, the first thing you will notice is that they are not actually

signed by hand, they are machine signed. This is often referred to as a *facsimile signer*. Typically, it is the signature of a senior executive who is one of the check signers. When signature cards are given to the bank, a signature card of the facsimile also needs to be provided.

As a control feature, many organizations require a second signature on all checks over a certain dollar limit. This limit varies widely from organization to organization. There is no right answer here. Whenever a check is given to an executive for signature, the backup for that item should accompany the check. Otherwise, frankly, it is a pointless exercise. This is not to say that all executives check that backup.

As many reading this are well aware, often the executive signs whatever is placed in front of him (or her). And this is not to say that accounts payable professionals don't take advantage of this. If they have a rush check and they want a quick signature, they will look for the signer who signs first and asks questions later—if ever. While this is not great from a control standpoint, it is a fact of life.

Checks being passed around for hand signature should also be kept in a secure manner. It is not uncommon to see piles of checks waiting for signature lying on an executive's desk or, worse, out on the secretary's desk in an open area. This should be a control issue. It is also an opportunity for anyone walking by to filch a check.

Once the checks are signed, they should be returned for processing immediately. Otherwise, another potential weak link has been introduced into the process. The point of enumerating what can go wrong is to give the professionals responsible for the process some ammunition to get the processes improved.

There are some segregation-of-duties issues associated with who can sign checks and who can do other tasks. So before adding someone to the approved check signer list, evaluate what that person's other responsibilities are. You

might refer to the Segregation of Duties chart in Appendix B for some guidelines. This is based on IRS guidelines.

## FACSIMILE SIGNER

The first facsimile signer was probably the rubber stamp. Going back maybe 20 years it was an accepted practice to have a stamp made up with the authorized signer's signature. As anyone who has ever used one of these knows, it was frequently given to the signer's secretary, who then signed away—even when the executive was out of the office and never saw the items in question. Today, not only is this not considered a good practice, it is among the very worst a company can employ. Not only will an organization using one flunk on the Sarbanes-Oxley audit control points, it will also forfeit all its legal protections for check fraud. Companies using these stamps are considered negligent and therefore responsible for the entire loss if check fraud occurs. So, if your organization is using them, make it your top priority to eliminate their use as quickly as possible.

Typically, the facsimile signer is a plate that is put in either the computer that prints the checks or a separate facsimile-signing machine. It contains the authorized signature and is used for signing checks. It is an authorized signer. Therefore, extreme care must be given to the storage and use of that plate. Placed in the wrong hands, it makes check fraud extremely easy.

The same care that is given to check stock should be given to the facsimile signer, sometimes referred to as a *plate*. From a control and segregation standpoint, the signature plate should be kept separate from the check stock. In an ideal situation where the staff is large enough, different individuals should have responsibility for the check stock and the signature plate or machine.

Leaving the signature plate in the machine unattended

can be a control issue. Leaving it in the machine (be it a printer or a check-signing machine) all the time is an open invitation to fraud, if the machine is not in a secure location. Remember, any blank piece of paper can be used to generate a check.

## RUSH CHECKS

If asked what function they would most like to remove from their accounts payable department, over 80% of all accounts payable professionals would probably pick rush checks, sometimes referred to as *ASAP* or *manual checks*. These are checks issued outside the normal payment cycle. Typically, they are drawn when the payee must be paid before the next check run. Reasonable excuses for these items include the sudden termination of an employee, expenses as closings that cannot be forecast with any certainty, and checks to vendors when the original invoice was never received. It is the last item that causes all the headaches.

Regardless of the reason for manual checks, they cause a disruption in the work flow of the department and for that reason are costly. Because they are handled outside the check cycle, certain tasks must be performed twice to ensure that the company's records are updated correctly. If positive pay is used (and, as you will read shortly, it should be), the bank must be notified or the payee will not be able to cash the check. Rush checks are one of the leading causes for duplicate payments and fraud because of the breakdown in normal internal controls associated with the check production cycle.

There are legitimate reasons for issuing an ASAP check. If the original invoice was not received and hence payment not made and the vendor is a key supplier threatening to put the organization on credit hold, a strong case can be made for issuing the check. This is especially true if not issuing it will result in a deficit of a key production ingredient that will bring

a manufacturing facility to a halt. Unfortunately, at least for the accounts payable department, many times when the vendor is threatening credit hold, it is not really because the original invoice was never received. Rather, it was received and disappeared into that black hole known as the approval process in purchasing. Of course, purchasing is telling the vendor that accounts payable is the abyss where its invoice was lost, but that is another story for another book.

The reality is at many organizations rush checks are routinely issued to cover the hides of professionals who have fallen down on their jobs in a variety of other departments. Often, management refuses to back accounts payable's requests to not issue rush checks. That is starting to change in a number of organizations as these management teams realize they could get dinged in their Sarbanes-Oxley audits if they routinely permit rush checks to be issued when purchasing neglects to review invoices submitted for payment in a timely manner. If this has not yet happened to your management team, add this to your list of reasons that rush checks should be limited. It really is an internal control point.

## MAILING CHECKS

Not everyone realizes that how checks are handled after they are printed and signed could be a control point. Leaving checks lying all day in the mailroom is a really bad idea. Why? In many organizations a large number of individuals, including temps and employees from other companies, could pass through the facility. If an individual who has larceny in his or her heart happens through and sees a stack of envelopes clearly containing checks waiting to be mailed, it will be a huge temptation. So, if you must use the company mailroom facilities, do not deliver the checks until right before the mail is taken to the post office.

Just because you are not taking the checks to the mail-

room does not mean you have fulfilled your internal control issues. Don't leave the checks lying around the accounts payable department either.

If you think we are making too big an issue of this matter and that your company's checks are mailed in discrete envelopes, ask yourself the following question: Does your firm mail checks in window envelopes or does it print and seal the check in an envelope in one process? Either indicates that a check could be enclosed to someone looking to steal checks.

When *Accounts Payable Now & Tomorrow* polled a group of its readers, slightly more than 14% indicated that they had improved their check-issuance process because of the Sarbanes-Oxley Act.

## OUTSOURCING CHECK PRINTING

As you can tell from what was written so far, for what at first glance appears to be a relatively simple process, check printing has numerous potential control issues and problems associated with it. And it definitely falls into the category of non-value-added functions. Hence, some companies choose to outsource their check-printing function, even if they outsource virtually nothing else.

Companies that employ this process for check printing go through their normal check-production cycle for everything, except they do not print checks. Instead, they transmit their check-issuance file to the outsourcer for printing. In most cases the outsourcer for this service is their bank. As long as the proper internal controls are associated with the process, the company is fine, and it avoids a slew of control issues.

If this approach is utilized, the organization needs to obtain an SAS 70 report from the check printer to cover its assessment of internal control responsibilities.

## CHECK REQUEST FORMS

When a payment needs to be made and there is no invoice, companies typically use a form to initiate the payment. This is another area that tends to have some control issues, and it can be the source of duplicate payments and fraud. While in an ideal world there would be no need for check request forms, that is not the reality of the world in which we live.

Controls should be built around the check request form process to ensure that they are not inadvertently written for an item that will later be paid with a check. That's another way that duplicate payments occur.

Check request forms are also a way that employee fraud is occasionally perpetrated. The very nature of the check request form makes it vulnerable to breakdown in controls.

The backup requirements for check requests are often laxer than they should be. However, that is starting to change, thanks to Sarbanes-Oxley. When *Accounts Payable Now & Tomorrow* polled a group of its readers, almost half indicated that they had strengthened their backup requirements for check requests because of the Act.

## POSITIVE PAY

As those reading this are probably quite aware, check fraud in the United States is a huge problem. The very best protection against check fraud is a product called Positive Pay. Some banks take the use of positive pay so seriously that they give their corporate clients a written offer. That letter asks them to use Positive Pay or sign that they have decided not to use it. By refusing the product, the company is giving up a lot of its protections against check fraud.

While the Sarbanes-Oxley Act itself does not mandate the use of Positive Pay, some experts believe that companies not using it are negligent on their internal controls.

## RECONCILE BANK STATEMENTS

Before Sarbanes-Oxley, timely reconciliation of bank statements was required if a company wanted to have any chance of not being liable for fraud should it occur. After the Act was enacted, that issue became clearer, although again timely reconciliation of bank statements is not spelled out in the Act. However, failure to do so will result in potential frauds going undetected, not being able to reverse unauthorized ACH (automated clearinghouse) debits, and loss of check fraud protections. Clearly, there are control issues.

Many reading this may think that this is not a problem at their firms, that they have a group or person responsible for the reconciliations and they work pretty autonomously and rarely cause a fuss. Check and make sure they are no more than 30 days behind. If the backlog is any greater, you have forfeited your protections and may get dinged on the Sarbanes-Oxley audit.

## RECURRING PAYMENTS

When you think of recurring payments, rent jumps to mind immediately. These are fixed payments made on a periodic basis, usually but not always, monthly. Loan payments and lease payments can fall under this umbrella as well. Savvy professionals looking to streamline their payables operations often set these recurring payments up for automatic payment, either by having a check issued in the appropriate check-production cycle or scheduling an ACH credit for the appropriate amount. Often, these payments do not have a maturity date. Hence, in theory, they could go on forever.

The evergreen feature is where the first control issue arises. There can be issues even without an evergreen feature In the case of a loan that is either paid in full or prepaid, or a lease that is terminated, the payments will continue unless the

system is notified to stop. In the case of a loan or lease, the maturity is often programmed in. Thus, it is important to incorporate strong controls to ensure that payments stop when the lease or loan matures or is prepaid.

## CONCLUDING THOUGHTS

The payment cycle is fraught with "opportunities" for those with thieving hearts to exploit weaknesses in less-than-perfect systems. To limit the opportunities for fraud as well as to meet Sarbanes-Oxley requirements, internal controls need to be strong, duties need to be fully segregated, and care needs to be taken.

# 5

# Purchasing Cards

The purchasing card is a means of streamlining the traditional purchase order and payment processes. Typically, it is used by organizations to pay for low-dollar purchases and is a way of getting all those small-dollar invoices out of the accounts payable department. It is generally viewed as an attractive payment vehicle for organizations looking to lower transaction costs. These cards are also referred to as *p-cards* and *corporate procurement cards*. The IRS refers to them as *payment cards*.

Much of the information in this chapter was put together with the National Association of Purchasing Card Professionals (NAPCP) (*www.napcp.org*). This was done through a survey that went to both its members and subscribers to *Accounts Payable Now & Tomorrow*. Appendix D contains an in-depth analysis of the survey respondents. I am indebted to the Association for both its willingness to participate and its allocation of resources for this project.

## P-CARD GROWTH

In the last ten years, as companies everywhere scramble to find cost-effective ways to handle the numerous low-dollar in-

voices that clutter the desks of their accounts payable staff, p-cards have stood out as a perfect solution to a messy problem. And companies everywhere have seen the light. While not every company uses this vehicle, it is believed that over half of all mid-size and large companies take advantage of them.

Through information gathered by the NAPCP, the 2003 Palmer Study, and the Aberdeen Group, it is possible to quantify growth at the firms that do use these cards. For example, the 2003 RPMG Research, P-Card Benchmark Survey revealed that when comparing 2001 versus 2003 there was:

- A 105% increase in monthly p-card spending
- An 18% increase in monthly spending per card
- A 12% increase in monthly transactions per card
- A 5% increase in spending per transaction

Similarly, Aberdeen Group's Purchasing Card Benchmark Report of March 2005 shows that between 2000 and 2004, expenditures managed via p-card programs have grown over the past five years at a compounded rate of approximately 21%. Over the same period, transactional volumes grew 15% per year, on average.

## TYPICAL USAGE

To give readers an idea of just how important p-cards have become in the payment community, the aforementioned Palmer study also measured average usage. It found the following statistics:

- Average transaction of $239
- Monthly spending per card $1,243
- An average of five transactions per card per month
- Average monthly spending of $1,642,000
- Average savings per transaction of $69

Moving forward, Palmer and the Association expect:

- Aggressive growth is expected in the p-card market.
- Per RPMG Research, 2003 spending will double in five years.
- Most organizations have not yet captured the bulk of their opportunity.
- Opportunity seems endless.

As part of its study, the Aberdeen Group identified those opportunities (see Exhibit 5.1).

Readers who want additional information about either of these initiatives can use the following contact information: info@rpmgresearch.com or Jeff.Pikulik@aberdeen.com.

Thus, it is imperative that companies not overlook their p-card programs when implementing controls and processes to conform with Sarbanes-Oxley.

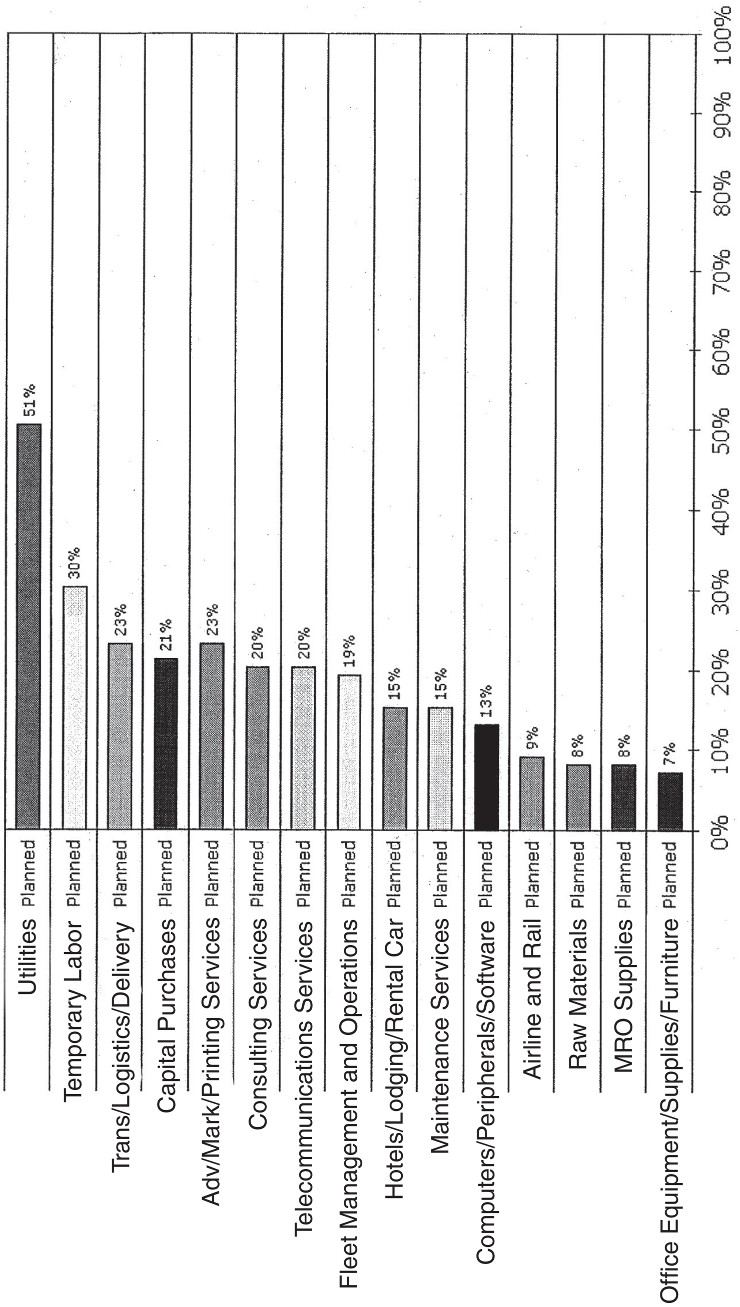
## THE SURVEY: HOW HAS SARBANES-OXLEY AFFECTED YOUR P-CARD OPERATIONS?

The survey was completed by 267 individuals, a number that is adequate to give us a representative view of what's going on in p-card operations as it relates to the Act. Private companies and not-for-profits were encouraged to participate in the survey. There are several reasons for this.

First, even though a company is private, it still may have to comply with the strictures. It may be required to do so by one or more of the following:

- Its bankers
- A key supplier
- An 800-pound gorilla customer
- Management team looking to implement strong internal controls

**Exhibit 5.1 Opportunities for P-Card Use**



Also, there have been rumors that some of the states will pass legislation requiring privates to conform with Sarbanes-Oxley-like requirements. Of the respondents:

- 58% were with public companies.
- 29% were with private firms.
- 13% were with other organizations such as not-for-profits, universities, municipalities, government, and so on.

Next, respondents were asked whether their organization was required to comply with the Act. Here's what they told us:

- 54%—yes
- 14%—not sure
- 8%—no, but they chose to comply
- 13%—no, but they had a different process established or were creating one to certify internal controls
- 10%—no, and they had no established process to make certifications about internal controls

Now, at first glance I was surprised to see that 54% replied yes, definitely, when 58% were employed at public companies. What this says (to me, anyway) is that not all public companies have raised Sarbanes-Oxley compliance to a very public level within their organizations. What is interesting is the 8% that had no obligation but were complying anyway.

For a complete breakdown of the demographics of the survey participants, refer to Appendix D.

## WHY COMPLY IF YOU DON'T HAVE TO?

As noted earlier, we were surprised by the significant portion of the group who reported that they were complying even though they were not required to do so by law. Survey participants were queried about whether they have been asked by customers, financial institutions, and/or suppliers about compliance. Here's what they said:

- 33% had been asked.
- 38% had not been asked.
- 28% were not sure.

Clearly, this is an issue on everyone's mind. Third-party processors for other organizations will have to comply, regardless of their own status, at least with the SAS 70 requirements, as their customers may be public companies.

There are two other reasons to comply with at least some of the provisions. First, compliance is a giant step toward strengthening internal controls—something that is generally good for any p-card program. Second, periodically there are rumblings that states will enact Sarbanes-Oxley-like resolutions for private companies. Of course, with 50 different legislatures enacting 50 different Acts, this could turn into a real nightmare.

## IMPLEMENTATION RESOURCES

As you may have read in the press, some companies are reported to have spent large sums of money getting into and certifying their compliance with the Act. We wondered if this had trickled down into the p-card operations, so we asked about the amount of time spent on Sarbanes-Oxley-related planning and implementation activities in regard to p-cards. Here's what the survey respondents said:

- 32% spent no time needing no additional activities.
- 30% spent a minimal amount of time, which did not interfere with daily routines and/or ongoing projects.
- 32% spent a moderate amount of time indicating that Sarbanes-Oxley was or had been a key project.
- 14% spent a significant amount of time indicating that Sarbanes-Oxley was or had been a top priority project that was pushed ahead of other priorities.

- 1% spent an extremely high amount of time indicating that Sarbanes-Oxley was or had been the sole focus of the organization interfering with everything else.

Quite a few organizations reported that they sailed through the Sarbanes-Oxley audits with flying colors because their internal control environment was so good. Part of this may be attributable to the fact that many programs are less than ten years old and thus have been implemented with fairly stringent controls and documentation. "The controls inherent to our p-card program went a long way towards complying with SOX," explained one respondent, in a response that was not atypical. "We only had to make a few modifications to be fully compliant," she concluded.

However, a few of the participants expressed frustration at the process. "There is a lot of redundancy in a short amount of time," wrote one participant. "Overkill," complained another. "It stymies innovation and firefighting, not to mention common sense." Things happen and things change. Not every step of an operation can be dictated. People need to think, make decisions, and make things happen—not just comply with a SOX process.

## WHO'S DOING THE WORK?

Well, we know what resources are being used in the organizations that reported either no or minimal time being spent on Sarbanes-Oxley-related activities, but what about the other organizations. Are they reallocating the current workload or getting some outside help? Once again we asked. This is one of those cases where people could select more than one answer. As you will see, the percentages do not add up to 100. Here are the resources used by our respondents:

- 22% relied on consultants and/or other outside professional services.

- 5% hired additional staff.
- 9% reassigned existing staff to focus exclusively on Sarbanes-Oxley and the p-card program.
- 37% asked the existing staff to incorporate Sarbanes-Oxley-related activities for p-cards into their current jobs.
- 19% set up a special team or committee specifically for Sarbanes-Oxley activities.
- 41% said this was not applicable to their operations.
- 7% said "other."

Some of the other applications included:

- A new external audit
- Implementation of a new program with specific Sarbanes-Oxley policies
- Internal audit hired a person to monitor the program
- Internet searches for appropriate policies
- The addition of compliance to everyone's task list

**SARBANES-OXLEY IMPACT ON P-CARD PROGRAMS**

Needless to say, some companies changed their programs as a result of Sarbanes-Oxley. We asked respondents how and gave them the opportunity to select as many responses as applied to their programs. Once again, the answers do not add up to 100.

- 48% reported no impact.
- 26% said Sarbanes-Oxley helped prove that existing controls were effective.
- 8% added more controls and/or procedures for which the benefit is not apparent.
- 23% added controls and/or made changes, which strengthened the program.
- 5% reported that their programs are more restrictive thanks to Sarbanes-Oxley.

- 12% said Sarbanes-Oxley forced them to document their policies and procedures as they were not previously documented.
- 6% indicated "other."

Specifically, the other respondents indicated that they had:

- Implemented company-wide controls
- A forced upgrade of policies and procedures
- Identified new p-card opportunities
- Ensured that expenses were posted to the proper fiscal period
- Identified a need to obtain SAS 70 reports
- Changed banks to improve information
- Greater opportunities due to documented controls

Thus, it can be seen that while for some companies Sarbanes-Oxley has been one huge pain with little to show, a significant number of the organizations surveyed have made meaningful changes to their operations. Even better, a number of savvy professionals have found ways to expand their programs due to opportunities identified in the Sarbanes-Oxley review process. Many of these professionals probably knew the opportunities existed, but without the Sarbanes-Oxley stick, they may not have been able to get management to go along with their recommendations.

## SARBANES-OXLEY FACTOR IN CHANGE

In many instances, not just p-card operations, the professionals who run a particular function want to implement certain changes but are thwarted by either management or employees in other departments. Thus, the enactment of the Sarbanes-Oxley Act was seen as a godsend in some of these

instances, as it provided the backing needed to force change. Some refer to this as the *Sarbanes-Oxley stick*.

Recognizing this potential, survey participants were asked if Sarbanes-Oxley was key in obtaining their organization's support to change certain processes that they had long wanted to change but their organizations had resisted. A respectable 7% indicated that this was the case. While this is not an overwhelming figure, it is worth noting.

Some of the changes that respondents were able to implement after running into a brick wall in the past are:

- Stricter controls on the cardholders.
- A streamlined program.
- Program support to focus on controls as top priority for program administration.
- Management support to discontinue some tasks that added little value.
- The hiring of a part-time temp to audit statements and receipts.
- The addition of improved controls and documentation requirements that result in additional clerical work for cardholders.
- Scanning p-card records.
- Internal controls and follow-up on questionable transactions.
- Sarbanes-Oxley has required the company to pay more attention to people's spending patterns, and managers as well as cardholders are held responsible.
- Supervisor approval of cardholder statements within a few days of receiving statements.
- Automating the statements.
- By demonstrating that needed controls are in place, the folks at the top of the organization are more at ease, which should lead to increased usage.

- Programs that were not rolled out properly with proper controls have added them.
- Tightening controls.

Basically, a number of respondents fully admitted using Sarbanes-Oxley as a catalyst to get internal audit on their side. One respondent noted that "employees don't argue with government mandates." Thus, however unintended, Sarbanes-Oxley has provided a number of professionals with just the ammunition they need to implement much needed, and often, long overdue change.

## HAS SARBANES-OXLEY FORCED CHANGE?

For slightly more than three-quarters of the respondents, Sarbanes-Oxley has not measurably changed their operations. A small number, 3% to be exact, indicated that their p-card operations have changed significantly, while 20% said there had been a moderate change. A whopping 52% showed no change, while a little more than one quarter (26%), said their operations were minimally changed. So, what changed where? Again, respondents could select more than one response:

- 43%—no change
- 10%—not sure if anything changed
- 19%—business strategy and/or policy concerning p-card use
- 15%—process and/or requirements for opening a new account
- 7%—identification of who can and cannot be a cardholder
- 11%—cardholder training
- 9%—management training
- 7%—process for closing accounts

- 10%—spending and/or transaction limits
- 6%—Merchant Category Codes (MCC) restrictions/allowances
- 9%—process for changing account limits/restrictions (temporarily or permanently)
- 10%—cardholder reconciliation process
- 16%—review/approval process for p-card transactions
- 19%—documentation requirements to support p-card transactions
- 11%—records retention (location and/or duration)
- 4%—access to p-card-related technology
- 22%—involvement of internal audit
- 5%—involvement of external audit
- 3%—accounting practices and/or general ledger entries for p-card
- 14%—responsibilities of program administrator/manager
- 1%—relationship and/or contract with card provider
- 6%—other

Other changes respondents have made include:

- The selection process of vendors who take the card.
- How data is received from banks.
- The documentation process.
- When users and managers are trained, they are reminded of the legal Sarbanes-Oxley implications.

Numerous respondents also pointed out that their Sarbanes-Oxley review was not completed and they were still in the process of evaluating change to their programs.

In reviewing the responses, it is clear that a significant number of companies are taking the Act very seriously when it comes to their p-card operations and are changing the way

they run their programs as a result. Perhaps the most telling comment came from a respondent who reported that "SOX compliance tightened our controls and brought in management support for strengthening the program."

## ADDITIONAL CONTROL FEATURES

A number of respondents reported that they had changed or added features. As you will see, most of the changes revolve around internal controls and fraud prevention. The following list contains the information reported by respondents (some of which you may have already incorporated into your own program):

- Email of review documents to the managers of cardholders, reviewing transaction details, account allocations, tax entries, and business purpose entries
- Independent verification that managers are aware of cardholder compliance
- Tighter restrictions placed on who could have a card
- Increased attention to "accidental" personal purchases put on the p-card
- Additional signature(s) for the issuance of new cards
- Documentation of all processes and roles and responsibilities
- Requirement of additional preauthorization for certain types of purchases
- Documentation of any exceptions to policy

One respondent reported that due to the lack of proper record maintenance in field locations, records were centralized. If one of your field locations has similar problems, this is a solution you might want to consider.

There was one other comment worth noting. One professional noted that Sarbanes-Oxley was one factor out of several supporting a decision to change the online program used for

## AUDIT RESULTS

We know that companies everywhere have been undergoing painful Sarbanes-Oxley audits. We wondered how p-card programs were faring. Thankfully, at least for the p-card world, there have not been too many out and out disasters. Here are the results from the group:

- 30% indicated that their organization does not comply with Sarbanes-Oxley
- 34% said that their program has not been officially audited for compliance
- 22% have had favorable audit results
- 7% have had mixed results with both successes and issues to be addressed identified
- 1% had audits that revealed much work is still needed to comply with Sarbanes-Oxley
- 6% had another result

Most in the 6% group indicated they were still waiting for the results of their audit. My favorite comment regarding Sarbanes-Oxley audits came from the professional who admitted that "We have had two SOX audits. The first was humbling. The second we passed."

Several respondents indicated they had some trouble getting SAS 70 reports from third parties to whom they had outsourced certain functions.

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managing transactions. Do your online programs offer the appropriate level of security?

### WHAT'S BEING CERTIFIED?

Since the area of subcertifications is so new, there is no standard. Thus, what one p-card manager certifies at Company A

might be different than what is being certified at Company B. Respondents to the survey were given the following choices to identify what they were certifying. Here's what they reported:

- 88% said the issue was not applicable to their situation.
- 3% were certifying that they had no knowledge of significant control weaknesses unless the weaknesses were specifically reported.
- 6% certified that the controls had been reviewed and they had no knowledge of significant control weaknesses unless they had specifically reported it.
- 2% said that the controls had been reviewed and they had no knowledge of control weaknesses above a specified numeric threshold (such as a percentage of revenue or assets).
- 0% reported that they had no knowledge of control weaknesses above a specified numeric threshold (such as a percentage of revenue or assets).
- 3% selected the "other" category.

Most in the "other" category indicated that they had no comment on controls or what they had to certify had not been clarified in their organization.

## RAMIFICATIONS OF NOT SIGNING

This is a really touchy issue. Directors and officers generally are covered by an insurance policy that would cover any errors or omissions on their part (with the possible exception of outright fraud). Most p-card professionals are not covered by such a policy. (*Note:* Even if you have "Director" in your title, you generally are not covered. The directors in the D&O [directors and officers] policies are generally limited to members of the company's board of directors.)

Luckily, this matter was not a consideration for most of the

## SUBCERTIFICATIONS

Subcertifications are one of the ugly results of the Act. Some chief executives and CFOs are not comfortable certifying statements that were the result of other people's work. Thus, at some companies, these executives are requiring the managers who report to them, and sometimes those several levels lower, to certify their work that goes into the preparation of the financial statements.

As part of the NAPCP survey, respondents were asked not only about the requirements at their firms, but also the ramifications of not signing, once asked to sign. Although this is not a huge issue in the p-card world, it is at a small portion of the operations. Here's what the survey showed:

- 6% are required to sign.
- 7% said the requirement to sign is optional.
- 63% said the issue is not applicable to them.
- 22% were unsure.
- 2% had another response.

The 2% that fell into the "other" category generally had some other sort of subcertification that fell short of the formal subcertification that requires a formal written signing of a document.

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professionals responding to the survey. A full 87% indicated the matter was not applicable to them. The remainder responded as follows:

- 1% said disciplinary action would be certain.
- 1% said disciplinary action would be possible.
- 5% indicated that although there were no specified pos-

sible ramifications, they believed that the employee's career would be negatively impacted.

- 6% thought there would be other ramifications.

In one case, the company required each employee who had the card to sign a subcertification letter. If they refused, their cards were revoked. Another assumed, and we concur, that refusal to sign would trigger an immediate audit. Most of the professionals who thought there would be ramifications were unclear as to exactly what they would be. Perhaps if the study is done in another year or two, some of the lack of clarity will be eliminated.

## CONCLUDING THOUGHTS

Clearly, Sarbanes-Oxley has raised the level of concern about controls in p-card programs, as well as other functions across the corporate domain. Although this is not a huge issue for most p-card administrators, it has made people aware of what could go wrong if proper controls are not implemented. Of course, there are a few organizations where compliance with the Act has been burdensome, but, overall, it does not appear to have been a huge problem. Perhaps the brightest light in the entire survey was the respondent who noted that they have continued to strengthen their policies for the p-card program, hoping to pay most of their accounts payable with a p-card.

# 6

# Electronic Payments: Alternatives to the Paper Check

Corporate America is *finally* starting to give up its paper-check security blanket. While wire transfers have long been used for high-dollar payments, that mechanism is an expensive proposition. Financial Electronic Data Interchange (FEDI), once considered the reasonable alternative, has been adopted by only a handful of companies. If these were the only alternatives to the paper check, it is unlikely that we'd see the demise of even a small portion of the paper-check market. But they are not the only alternatives.

There has been a seismic move in the corporate environs toward making payments via the automated clearinghouse (ACH), mostly through the use of ACH credits, and in limited instances through a debit vehicle referred to as an *ACH debit.* If you are planning on skipping the sections on ACH because your firm is not currently initiating payments through that mechanism, please reconsider. For starters, there are types of

ACH fraud that everyone, regardless of whether they actually use ACH, can be hit with. Then there is the issue that even companies that have no plans to use ACH suddenly find themselves making payments that way when a large supplier demands electronic payments.

## WIRE TRANSFERS

### Who's in Charge?

Wire transfers may be a reasonable payment alternative when sending millions or even hundreds of thousands of dollars. The cost for a wire can be as high as $50, although typically it is somewhat lower. The first issue regarding wire transfers relates to where the responsibility for the function lies. This can be a serious consideration. In 50% to 75% of all organizations, the treasury group does the wire transfers, while checks are issued in accounts payable.

In those numerous instances where wire transfers are handled by a different group than those who are responsible for checks, there needs to be a coordination between the two groups. Why? Because in more instances than anyone would like to admit in public, many invoices that are paid with a wire are then paid again with a check. One of the ways this happens is that when a payment is late, the vendor will insist on a wire transfer. Then, when the original invoice finally does show up, it gets paid. One way to avoid this is when the vendor screams for a wire transfer, try and convince them to take an ACH payment. This will keep the payment in accounts payable and the cost down and hopefully reduce the risk of a duplicate payment.

More to the point, to tighten controls, consider moving the responsibility for wire transfers to accounts payable, where other payments are originated.

### Types

Wire transfers can be broken into two broad groups. The first are those that are made on a recurring basis, and the second are one-time or irregularly made payments. This distinction is important when it comes to setting up wires online. It is also important when consideration is given to controls, fraud, and duplicate payment prevention.

### Initiating a Wire Transfer

Wire instructions can be sent to the bank online or by phone. Regardless of which initiation technique is used, the instructions need to be verified by a party other than the one who initiated the transaction. This is an important internal control point. It is especially important when it comes to preventing fraud. The list of people authorized to initiate wire transfers, as well as those authorized to approve the wires after they have been initiated, should be limited to a small group of individuals. As with checks, this is not something that all executives should automatically have authority to do.

Now, when wires are done online, the process typically involves typing in the requisite information. Each approved person should have his or her own user ID and password. While it is not rocket scientist work, it is a task that involves some responsibility. Rarely is this task assigned to a clerical person, but that does not mean that in some organizations the clerical staff does not enter the data. Yes, that's right—in some organizations the person who enters the data is not the one who is authorized to enter it.

Unfortunately, this can lead to fraud. Sharing passwords and user IDs is a very bad idea. Now, before you start to explain that the person in your organization who's been entering the wires, even though not authorized, is a long-term trusted employee, consider this. Most employee fraud is committed by long-term trusted employees.

**Fraud**

It is not uncommon for a company to receive a call asking for wire instructions by someone looking to pay the company. Most of the time these are legitimate requests. However, occasionally, they are not. Crooks have figured out that calling and asking for wire instructions claiming they are getting ready to pay a company is one of the easiest ways to get a company's bank account number. And what are you going to do—not give someone the wire instructions?

Therefore, some companies use one account for wires and another for checks. If someone tries to write a check against the account, it will bounce because the account cannot honor checks. This is not a Sarbanes-Oxley requirement, but it is a good internal control point and could help you avoid getting dinged in the audit.

## AUTOMATED CLEARINGHOUSE (ACH)

Americans' love affair with the paper check is finally abating. This is one area where the United States lags behind the rest of the world. In fact, in many parts of the world, checks are rarely written, with most payments being made electronically.

A reasonable number of organizations are making payments or are considering making payments in the near term using the ACH. The most common examples of ACH payments are direct deposit of payroll and Social Security payments. These are referred to as *ACH credits*. If you allow your bank to automatically deduct your monthly mortgage payment from your bank account, you are using ACH debits.

This type of payment is infinitely more affordable than wire transfers. At approximately ten cents per item, ACH payments are even cheaper than paper checks. To be perfectly honest, ACH payments have fewer control problems associated with them. There is no concern about employees in the

mailroom snatching the payments, payments don't get lost in the mail, and so on.

**Authorization**

In order to pay vendors electronically, it is necessary to have them sign up. Care must be taken with the forms that vendors fill out with all their secure information. It should not be kept where anyone can stumble across it. Treat it as though it were your own bank information.

Once they start making payments using the ACH, most companies want to expand their programs. From a control standpoint, it is important that all payment mechanisms (e.g., checks, wires, and ACH) are coordinated so that duplicate payments are not made and weaknesses that will allow fraud are not introduced into the processes.

One of the good things about the ACH payment mechanism is that because it is relatively new in most organizations, the controls surrounding it are usually good. Typically, but not always, because there is generally some reluctance to start paying electronically, a company will have instituted decent internal controls around the process.

**Positive Pay**

Care must be taken when paying electronically. The reason for this is that Positive Pay does not work with ACH payments. Although there is talk about developing a product, there is not one currently available. Remember, ACH can work as either a credit or a debit. While ACH fraud is not nearly as prevalent as check fraud, it does exist and you need to protect against it. So, as a rule of thumb, unless you allow ACH debits, you can put an ACH block on your accounts.

When *Accounts Payable Now & Tomorrow* polled a group of its readers, just under 15% indicated that they had improved

their electronic payment process because of the Sarbanes-Oxley Act.

### Recurring Payments

The ACH can be used automatically, as with checks, to make recurring payments (e.g., mortgage, rent, lease, loan payments). As with checks, it is a good control point to set these payments up with a maturity date so that they do not go on after the maturity of the obligation. Additionally, it is a good idea to periodically review recurring payments to make sure that none should have been terminated. This might happen if a loan is prepaid or the interest rate renegotiated or if a property is sold, thus ending a mortgage obligation.

Some companies review their list of recurring payments each month before they are made to ensure that all the obligations are still outstanding.

### SAS 70

Yes, some companies outsource their ACH initiation, and if this is done, don't forget to ask the outsourcer for its SAS 70 report. If one bank initiates all payments from one file, then only one SAS 70 report will be required.

This might be a good time to comment on SAS 70 reports. The Sarbanes-Oxley Act actually requires such documentation only if the task in question could make a "material" impact. While it is likely that the initiation of payments would not fall into this category, it is still not a bad idea to get the report.

## DAILY RECONCILIATIONS

For several reasons, it is a good idea to reconcile bank accounts daily when it comes to ACH payments. Since Positive

Pay doesn't work with ACH payments, the protection offered by that product is not available. Additionally, corporations have a very short time frame to dispute incorrect or invalid items. Thus, from an internal control standpoint, whether you use the ACH mechanism or not, the frequent checking and verification are important.

## CONCLUDING THOUGHTS

The ACH payment mechanism is rapidly gaining acceptance. As check fraud remains a big problem, the efficiencies ACH introduces into the process are undeniable, and it is actually the least expensive payment alternative available. Even if your firm is able to dismiss these considerations, a number of vendors are demanding that their customers pay them electronically as part of their contract. Thus, most experts believe it is only a matter of time before every company will be making payments electronically.

Many banks already have products that allow consumers to make electronic payments, and some are developing similar products for small businesses. The fact that the process is new means that accounts payable will not have to live with antiquated policies and procedures that are full of weaknesses and internal control points.

If your company decides to introduce an electronic process—and it probably will if one is not currently in use—take the opportunity to make sure that no weaknesses are permitted. Develop strong procedures that have the appropriate checks and balances and control points built in.

Additionally, the processes for the ACH need to be integrated into the entire payment process and tie into good control points.

As the technology emerges, accept more changes and improvements to the electronic payment world.

# PART III

# Functions Related to and Often Handled in Accounts Payable

# 7

# Travel and Entertainment Expense Processing

If I had to select the one area where internal controls are more than occasionally overlooked in the corporate world, it would be in the area of travel and expense (T&E) processing and reimbursement—that is, until the passage of the Sarbanes-Oxley Act. In fact, when *Accounts Payable Now & Tomorrow* polled a group of its readers, close to 60% indicated that their T&E reimbursement and review processes had been improved thanks to the passage of the Sarbanes-Oxley Act. The Act finally forced companies to stop looking the other way or taking the boys-will-be-boys attitude when certain employees flagrantly abused the T&E policy. It also helped put an end to the poor practices that taxed the accounts payable department while catering to the whims of a few.

## BAD PRACTICES

The number of really bad practices associated with T&E, even at organizations that normally use nothing but best practices,

is mind boggling. Some are simply a holdover from simpler times, while others border on the absurd. What am I talking about? Most everyone understands the advantages of including T&E reimbursements with the paycheck or electronically depositing those funds into the same bank account as the paycheck. Yet, in some organizations, employees, including some very senior-level executives, balk at this suggestion.

The reason in many cases is that they don't want their spouse or partner to know about these funds. Thus, they insist on encumbering the accounts payable operations with burdensome procedures so they can hide these reimbursements. Ever so reluctantly, some companies that had tolerated this practice are putting an end to it. Not only did these practices tax the resources in the accounts payable department, they generally included weak controls and occasionally were instrumental in the perpetration of employee fraud.

Practices related to T&E that are considered poor and in some instances weaken internal controls include:

- Cash advances
- Returning reimbursement checks to the traveler instead of electronically depositing them in the employee's bank account
- Not giving all employees the same benefits
- Not getting receipts for expenditures over the threshold limits

Any company with a written T&E policy probably believes it is giving all its employees the same benefits. But this is not always the case in practice. When certain managers routinely approve expenditures in excess of what is mandated, the policy is not being implemented uniformly. To be honest, this is rarely intentional but happens all the time across the corporate world.

## WRITTEN POLICIES

To have an effective policy with the appropriate controls, the first requirement is that the policy be written down, endorsed by management, and then distributed to all affected employees. Management needs to make it clear to all employees that it stands behind the policy and will back accounts payable in enforcing the policy. Otherwise, the policy has no teeth, and accounts payable is left powerless. If it is not enforced across the board, it could be seen as a weak control, and the company could be dinged both on its Sarbanes-Oxley audit and in the overall audit.

T&E is probably the easiest place for an employee to commit fraud against his or her company. In fact, there is a book on the market that provides the details of how an employee can easily perpetrate such a fraud. Thus, it is important that tight controls around the whole T&E policy be established and enforced. It is also necessary that the corporate culture be taken into account.

One accounts payable manager at a large financial institution recounted that in her organization every report submitted by its traders was checked in detail, even if the trader's manager had approved the report. Often, there were expenditures in excess of the policy, which was why all the reports were checked. The manager explained that because these people dealt with such large sums of money all day, they considered T&E to be trivial. Therefore, the managers signed whatever was placed in front of them. They were not going to check closely a T&E reimbursement request for $789 when they spent their days dealing with millions of dollars.

Of course, for accounts payable to be able to enforce the policy, management must back them. Otherwise, not only is the checking an exercise in futility, it will also cause the department to lose face and weaken it for other battles. Being

overridden by management is the last thing that accounts payable needs. So choose your battles wisely.

For the policy to be effective, it also needs to be reviewed periodically and updated accordingly. What was considered a best practice yesterday may no longer be so.

## POLICY ENFORCEMENT

Finding violations to the T&E policy can be very easy if one of the electronic T&E systems is used. However, most companies, even those that have some sort of an automated system, do not have one with all the bells and whistles that flag policy violations. In fact, some not only flag these infractions, they don't let the employee submit the report until they are fixed.

If there is not an automated approach to reviewing T&E reports, it will be necessary to devote more human resources to the problem, assuming accounts payable has the authority to handle such reviews and demand that policy infractions be fixed. This is not always the case. Thus, it will save a lot of wear and tear on everyone involved if this issue is addressed honestly.

The first decision is to what level the company wants accounts payable to check T&E reports. Is it just for mathematical errors and to ensure that the proper documentation is attached? Is the responsibility for adhering to the policy left to the approving manager? This is an issue that should be resolved and spelled out for both the accounts payable department and the submitting employees. Otherwise, when accounts payable calls about an expense that does not conform to the policy, the conversation—not a pretty one to start with—is likely to get downright ugly.

There is no right or wrong answer to the "who's responsible" question. From a control standpoint, the important issue is to make sure someone's checking. This is especially important for another reason. More than one case of employee

fraud has been uncovered because the employee who was defrauding the company also was cheating on his or her T&E. Fraud sometimes starts with T&E, and other times spreads to T&E.

To summarize, checking the T&E report is important from both control and fraud prevention points of view.

## SPOT-CHECKING

Whether just checking for mathematical accuracy and receipts or for policy compliance, the issue of just how much checking is required needs to be addressed. Some companies check every detail on every report, while others check only a few randomly. Clearly, from a control point of view, it would be ideal to check every line on every report. But is this really an effective use of the resources in accounts payable? Most experts think it is overkill. Some refer to it as "spending a dollar to save a dime."

What is generally recommended and considered adequate is to spot-check reports. Each month a certain percentage of reports are selected for an in-depth review. Some companies go as low as 5% in this review. Others are not quite that liberal. This is where some numbers might come to your rescue.

If your firm is currently reviewing all reports and management is reluctant to change, you might recommend reviewing half the reports. For a few months before the change, track how many changes are made at the request of accounts payable. Also, keep a tally of how much money was actually saved (expenses originally submitted but not accepted). Use this number in two ways. First, if management is dragging its feet on having accounts payable check only half the reports, demonstrate the financial impact of this review. (*Note:* If the amount refused reimbursement is large, your company is not a good candidate for reduced checking. But most companies rarely reject a claim.)

Once you've succeeded in reducing the number of reports tracked, continue to benchmark your numbers. If there is no increase, go back and ask for a reduction in the percentage checked. Most organizations find that they have adequate control coverage by checking 5% to 10% of submitted reports plus the exception items.

For this to work effectively, it must be made crystal clear to all employees that anyone caught cheating on their expense report will be terminated. Should it happen (yes, I know this is ugly), the promise must be kept and it should not be kept a secret. We are not talking about firing someone for a minor infraction, but for what is obvious fraud. For example, if two employees travel together and both put in for the same meal listing the other as a guest, you could have a problem. While the amount involved is relatively small, the implications are clear. This is a policy decision that needs to be made at senior levels. It is not accounts payable who makes this determination.

## EXCEPTIONS TO SPOT-CHECKING

In every organization there are a few rogue employees who get very creative when filling out their expense reports. If you talk to the staff in accounts payable, most likely they can tell you who these individuals are without batting an eye. They go on the list of those whose reports are always monitored. When in doubt, put an individual on that list.

The list should also include individuals who have submitted dubious expense reports in the past. Also, include all reports over an expenditure level of a certain amount, say $5,000, although this figure will vary by company.

From a control and fraud standpoint, you might want to include the reports of employees traveling together. Anyone who has ever been in a restaurant realizes that it is possible to get as many as three receipts for each meal. Similarly, vouchers for taxi rides are easy to come by.

Finally, each year, several employees should be selected, without their knowledge, and their reports for an entire year should be reviewed as a package. On more than one occasion this type of review has uncovered copies of the same receipt on multiple expense reports.

## WHO SUBMITS WHEN MULTIPLE EMPLOYEES ARE INVOLVED?

Often, especially when a lunch or dinner is involved, multiple employees are involved in the outing. Traditional business etiquette says that the lowest-ranking employee should pick up the tab and put it on his or her credit card. Since the company is ultimately paying the bill, it really is irrelevant who actually signs for the meal.

From a control standpoint, this is the wrong approach. The highest-ranking employee should pay and submit. In this manner, someone who was not at the event will ultimately have to approve the expenditure. If the company wants to continue having the lowest-ranking employee pay the bill, the T&E report should be sent up the chain and should be approved by an employee who was not at the event. Of course, this leaves the guy at the bottom of the food chain vulnerable for an inappropriate expenditure should it violate policy. This is not really fair. Thus, we strongly recommend that the company policy require the highest-ranking employee to pay the bill and submit for reimbursement.

There is another reason to enact such a policy. Occasionally, a group will go out for a meal (or attend a sporting event, etc.) and the low guy will submit the expenditure for reimbursement while someone else involved in the occasion approves it for payment. This effectively removes all controls. There is no unbiased oversight and, if you want to stretch the point slightly, no segregation of duties.

## ELECTRONIC REIMBURSEMENT

In what is clearly a worst-practice environment, T&E reimbursements are handled by providing a check that is not mailed. Employees are notified when their reimbursement checks are ready and either they or an assistant or a secretary go over to accounts payable to pick up their checks. If this sounds like a reasonable practice to you, you have never seen it in action. Here are just a few of the problems involved:

- Employees wander into accounts payable throughout the day at their convenience, interrupting the work flow of the individual handling the checks.
- The employee's secretary comes over to pick up the check, and then the employee comes in some time later, causing a ruckus when the check can't be found.
- The secretary or assistant places the check on the employee's desk and it gets lost in a stack of paper.
- The secretary or assistant steals the check.
- The secretary or assistant perpetrates a fraud by forging T&E reports under the boss's name and then keeps the reimbursement check.

Remember, employee frauds are generally perpetrated by long-term trusted employees, not those suspicious-looking new hires that no one knows.

Between the efficiency issues and the control points, there is no longer any good reason not to handle all T&E reimbursements electronically. While it is not legal in all states to require direct deposit of payroll, companies can mandate it for T&E reimbursements, despite the fact that many are reluctant to do so.

By the way, companies often permit employees to select a different account for T&E reimbursements than for payroll. Some have very legitimate reasons for requesting this. Why

they want that second account is not an issue that the company needs to concern itself with.

If the company is not willing to mandate electronic reimbursement, it should eliminate the practice of picking up the checks. Checks can be mailed to the employees' homes. This will eliminate some of the control and fraud points discussed above.

## T&E CARDS

Companies take several approaches to paying for T&E. Each has its own control and fraud issues. Here are the options:

- Employees use their own credit cards and submit T&E reports with receipts for reimbursement. The company has no liability for the expenditures. The problems with this approach include:
  - Handling travel expenses for employees whose credit is poor or has not been established, making it difficult for them to get cards.
  - There is no verification as whether an item was returned. This can be a big issue with regard to air travel when an employee could theoretically book several air flights for the same trip, submitting the most expensive receipt while taking the cheaper flight and canceling all but the cheap flight. Companies can get around this by requiring that traveling employees submit their credit card bills for months following the travel. However, many would see that requirement as an invasion of privacy.
  - Some employees balk at having to use their own credit to effectively float their companies.
- The company secures a credit card but requires that the employee pay the bill directly. The related issues include:

    - Typically, in such arrangements, the company is ultimately on the line if the employee defaults. This helps with employees who might have trouble qualifying for their own credit cards.
    - The company is left holding the bag if a departing employee chooses not to pay his or her last bill or, worse, runs up a large personal bill before departing.
- The company secures the credit card and pays the bill directly. The issues related to this approach (which is probably the fairest) include:
    - Because they have no payment responsibilities, the employee has no pressure to fill out and submit the T&E report. Since this is a task that many see as onerous and not adding any value, there often needs to be some reward associated with the task or a penalty associated with failing to complete it.
    - Departing employees have been known to run up large personal bills before leaving.

From a control standpoint, it is crucial that all cards of departing employees be terminated immediately. Sometimes this requirement falls between the cracks, opening the company to potential, albeit limited, fraud.

**SAS 70**

Because T&E definitely falls under the noncore functions, many companies outsource the reporting. If you do this, don't forget to ask your outsourcer to provide an SAS 70 report. The outsourcer may inform you that its services are not material and therefore you don't need the report, and technically they would be correct. But this does not mean that you shouldn't get the report.

While everyone concedes that SAS 70 reports are not perfect, they are a step in the right direction. If the outsourcer

drags its feet about providing one, that could be a sign that something is not right. Or it could simply mean that it doesn't have one or is not concerned about the issue. Whatever the reason, it should raise some flags.

## EXCEL REPORTS

Many organizations use T&E reports that are based on Excel. In fact, some are simply Excel spreadsheets with formulas built in. In most cases these handy forms do a more than adequate job of presenting the information in an acceptable format and eliminating mathematical errors. Or do they? The formulas need to be locked. Otherwise, a crafty employee can alter the formula so it seems like the math is correct when actually it is not.

Worse, depending on the sophistication of your form, in some cases the Excel spreadsheets have no formulas and are used like Word documents. Yes, the information is much easier to read than those awful handwritten forms, but that is all. The math still needs to be verified. Some are lulled into a false sense of security by the presence of Excel. So, check the formulas, make sure they are locked, and if not, verify the math.

From a fraud perspective, even an Excel spreadsheet that originally had the formulas locked could present a problem. How? A thieving employee could create a new Excel that looks exactly like the existing report, but the formulas could be different. The employee would be stupid to do such a thing, given the small amount that could be generated this way, but would probably go undetected for sometime.

When doing your oddball once-a-year verifications, check the formulas in some of the Excel spreadsheets and make sure they are what they are supposed to be.

## ONE-CARD PROGRAMS

As those who deal in the p-card world know, many of the p-card programs have rebates associated with them. To encourage us-

age, most of the card issuers will give their corporate clients with p-card programs a rebate based on the amount charged each period. Some companies see this as a huge incentive, a way to make the program pay for itself. Whether this is a smart approach or not is a subject for a different venue and will not be addressed here.

It was only a matter of time before those organizations intent on getting the largest rebate possible turned their attention to their T&E programs. What if they could get that rebate on their T&E expenditures? And, while they were looking for ways to expand that rebate, what about all that money they were spending on fuel?

Thus, one-card programs began to spring up. While not every organization has the fuel component, one-card programs typically encompass:

- P-cards
- T&E
- Fuel

Incorporating T&E with p-cards and fuel could make the tasks of policy compliance and fraud detection a little more difficult.

## CONCLUDING THOUGHTS

Hopefully, it is apparent at this point that the T&E function is more vulnerable than other functions at a large number of companies. Because in many cases it has not received the attention it deserves, in the past when it came to operating under best practices, it is now under more intense scrutiny. That's why more than half noted in the *Accounts Payable Now & Tomorrow* poll that they had tightened up their review processes as a result of the Act. It also means that for accounts payable and their organizations there are opportunities to tighten controls and improve fraud detection surveillance.

# 8

# Unclaimed Property (Escheat)*

Simply put, unclaimed property laws, sometimes referred to as *escheat,* require all companies to remit to state governments all unclaimed property. Among other things, this includes:

- Uncashed checks to suppliers
- Unapplied credit balances
- Uncashed payroll checks

## STATE OF COMPLIANCE

To be perfectly candid about unclaimed property reporting, a significant number of companies, in the past, simply ignored the matter. They would write uncashed checks off to miscellaneous income and reverse the entries on their books. Now

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*I had great assistance on the material in this chapter from Karen Anderson of Unclaimed Property Recovery and Reporting (UPRR). An escheat professional who has been involved in the unclaimed property compliance industry for over 18 years, Ms. Anderson is an attorney. She has served on the policy staff of a former Illinois governor and as Illinois's Unclaimed Property Administrator. She was the first administrator of the National Association of Unclaimed Property Administrators (NAUPA).

chief executives can no longer take such a cavalier approach. If Sarbanes-Oxley isn't enough of a threat to force compliance, the states, ever hungry for additional sources of revenue, are auditing for noncompliance. When they find an organization that has not been in compliance, not only do they assess for the funds that should have been turned over, but they also levy penalties for the infractions. The rules and reporting deadlines vary from state to state, with the vast majority of the states having a November 1 reporting deadline.

What's more, the states have taken to hiring third-party audit firms to collect on their behalf. Frequently these third parties are compensated on a contingency basis: the more they collect, the more they earn. Complicating the matter, at least from the company's point of view, is the fact that some of these auditors work for more than one state.

Karen Anderson, an attorney with Unclaimed Property Recovery and Reporting (UPRR), says that the Sarbanes-Oxley Act (SOX) has definitely had an impact on unclaimed property compliance by public companies. She notes that the Sarbanes-Oxley certification requirements for controls and procedures have driven companies to enhance compliance efforts in many areas. Escheatment, which had taken a backseat in some companies, has now come into focus as an area with possible overstatement of income or understatement of liabilities. The impact varies among companies, depending on the level of previous compliance, the nature of the company, and property types a company may hold.

## EFFECT OF SARBANES-OXLEY ON PRIVATE COMPANY REPORTING

Interestingly, Anderson notes that similar to other compliance areas, Sarbanes-Oxley has led private companies to review their compliance procedures and activities as well. She notes that while accurate disclosure and control requirements

are not mandated for private companies, public perception and ethics have guided some private companies to follow the tenets of Sarbanes-Oxley.

Consequently, due to the link between accurate financial statements and escheatment compliance, some private companies have now emphasized unclaimed property compliance. This is another example of how private companies have been influenced by the far-reaching arm of the Act.

## KEY ESCHEAT ISSUES

Anderson breaks down the most important concerns into two key issues. She says that the most important Sarbanes-Oxley-related unclaimed property compliance concern for most companies is having adequate controls and procedures to timely identify items that are reportable to states as unclaimed property in accordance with individual state statutes.

A second concern is that corporations are filing timely and accurate reports as required by all states. In connection with this, the company must have a mechanism for being updated on the ever-changing state unclaimed property laws. Further, she points out, even companies that have established procedures and controls for unclaimed property compliance may not be applying the controls and procedures to all departments or business units that hold unclaimed property.

## COMPLIANCE

Getting into compliance takes some work. Anderson delineates the following steps to help an organization achieve compliance:

Step 1. A company seeking to ensure compliance should make compliance a management directive to the appropriate staff, including internal auditors.

Step 2. The company should educate pertinent staff about unclaimed property compliance or seek experts to assist them in the escheatment management process.

Step 3. Internal audit staff or the hired experts should perform a risk analysis to determine if the company has past due liability and the extent of that liability.

Step 4. Resolve any past due liability discovered via internal due diligence efforts, initial compliance with a state agent, voluntary disclosure, or amnesty agreements.

Step 5. A compliance function led by a management designated staff person should be created. This process should involve the pertinent staff of all departments that may hold unclaimed property. Specific controls, procedures, and timetables must be developed by the committee or their hired expert.

**WHAT'S REQUIRED TO DO ESCHEAT CORRECTLY?**

Since your executives will be under greater scrutiny, it is important that the escheat function be handled correctly. The following list was compiled by Anderson so readers can ensure that they are doing everything they should be when it comes to managing the unclaimed property function:

- Identifying and researching eligible property items (including procedures for reversals and maintenance of reversal documentation)
- Due diligence mailings or publication (when required)
- Updating state law and regulation information
- Development of reports
- Development of remittances
- Review of remittances developed
- Record retention and maintenance
- Task assignment, including separation of duties

## COMMON NONCOMPLIANCE AREAS

There are some common areas of "noncompliance," even in those companies that have procedures in place to comply with state unclaimed property laws.  One of the most common is accounts receivable. Unused credits, rebates, and refunds are reportable property under most state unclaimed property laws. There is no blanket exemption from reporting these items for companies that are currently doing business with one another. While there are a few states that have exemptions for credit memos and balances, these exemptions often require interpretation and careful review in order for them to be validly applied, explains Anderson.

She also notes that outsourced situations can cause problems when it comes to escheat compliance. When a company contracts with a third party to disburse payroll, benefit, royalty, or other checks, a clear definition of escheatment responsibilities is essential between the parties. Often, the company that outsources this responsibility believes the third party has the responsibility for escheat, but unless the responsibility is clearly specified in the outsource contract, the third-party company may not be complying with state escheat laws, warns Anderson.

Even if the outsourcer is responsible, Anderson recommends that accountability measures should be implemented. Best practice would dictate that the company that outsources the responsibility obtain periodic documentation or audit that the appropriate compliance process is in place.

If you are thinking that this is overkill, Anderson explains why it is not. Ultimately, most state unclaimed property administrators will hold the company outsourcing the function liable for noncompliance. Therefore, she says, a clear definition of escheat responsibilities between outsourcing parties and accountability measures are essential for appropriate escheat compliance and, correspondingly, Sarbanes-Oxley Act conformity.

## SUBCERTIFICATIONS

Generally, notes Anderson, companies are incorporating the Sarbanes-Oxley review into their internal audit process. Due to the Act, internal auditors often include an escheatment controls checklist as a part of their review procedures. She finds that when it comes to unclaimed property, the use of a Sarbanes-Oxley-related escheat “subcertification” is not prevalent at this time.

## SEGREGATION OF DUTIES

The funds escheated to the states rarely have a high profile within an organization. Thus, this money is a prime target for knowledgeable individuals intent on thievery, since it is unlikely in all but the very largest companies that the individuals responsible for unclaimed property do not handle other corporate functions. Care should be taken when assigning this responsibility to ensure that the people responsible for unclaimed property are not also given responsibility for conflicting areas, such as bank reconciliation.

When *Accounts Payable Now & Tomorrow* polled a group of its readers, 14% indicated that they had improved their unclaimed property compliance process because of the Sarbanes-Oxley Act.

## CONCLUDING THOUGHTS

Without a doubt, complying with unclaimed property laws has become a high priority for public companies, especially those that had ignored the rules in the past. Remember, being in compliance with all state and federal laws includes unclaimed property laws.

# 9

# 1099s and Other IRS-Related Information Reporting

The difference between an independent contractor and an employee is crucial when it comes to reporting income and paying taxes. You may think someone is an independent contractor when, in reality, the individual falls under the classification of *employee*. While it has always been important that reporting be accurate, in light of Sarbanes-Oxley and the executive certification that the corporation is in compliance with all state and federal laws, accurate reporting is essential. And, while we're on the subject, do not forget about state independent contractor reporting. Eleven states or U.S. territories now have similar reporting requirements. While just under 30% of those polled by *Accounts Payable Now & Tomorrow* indicated that they had changed their 1099 processes because of Sarbanes-Oxley, we believe that once the full implications of the related functions are fully understood, that figure will escalate.

## DETERMINING STATUS

The first thing that must be done is to determine the employment status of an individual. This is not always as easy as it

might appear at first glance. In a much-watched case several years ago, Microsoft had to reclassify a number of independent contractors as employees. They also had to pay certain taxes and back benefits and make contributions to the pension plan on behalf of those individuals. It was a costly settlement for the company. How can you make sure that your organization does not fall into the same trap? The IRS has devised a set of 20 questions to be used to determine the employment status. For your convenience, Appendix E contains the questions.

## OBTAINING A W-9

As those who work in accounts payable know only too well, the best approach when making a payment to any vendor of any sort is to require a W-9 before any payment is made. While it is not a legal requirement that this information be obtained in writing, it is a very good idea. From a control standpoint, accepting the information verbally is an invitation to problems. If the information is wrong, there is no audit trail of where it came from or who made the mistake. Was the transposition the fault of the person writing the information down or the person providing it verbally?

Without the tax identification number (TIN) information, you are required to withhold 28% federal tax. This is something that should be pointed out the next time vendors or independent contractors drag their feet at the request for the information. If you cannot get the information and do not withhold, your CEO cannot certify that the company is complying with all state and federal laws.

## 1099S AND YEAR-END REPORTING

From the TIN information, determine if the individual or entity must receive a 1099 at year end. If a 1099 is required, payment

information to that individual or entity needs to be tracked very carefully. Once the thresholds are breeched, a 1099 will have to be issued. It is important—and from a control standpoint, this is where there are frequent breakdowns—that payments from all entities and all mechanisms be included. Thus, if several subsidiaries or divisions make payments, they must be accumulated. Similarly—and this is a big one—if someone is paid with a check, wire, and credit card, all payments must be included. As you might imagine, payments made to independent contractors with a credit card can sometimes create a 1099 reporting problem. This is addressed later in the chapter.

It seems like the rules for 1099 reporting change each year. Thus, in many organizations, the professionals responsible for handling this reporting are sent for training to be updated on these issues. Several good venues exist for this, including:

- An annual conference held by irscompliance.org and *Accounts Payable Now & Tomorrow.* This is scheduled for July 2006 in Orlando and 2007 in Las Vegas.
- Numerous one-day sessions held locally during the last three months of the year by the American Payroll Association.
- Numerous webinars offered by irscompliance.org.

While it is possible to keep up to date on all the changes by reading all the IRS rulings, it is a better use of resources to spend a few dollars to rely on the compilation of the IRS information by the experts.

## TIN MATCHING

One of the problems even the most fastidious of accounts payable professionals runs into with W-9s is the fact that the information provided often does not match what the IRS has

on its records. In the past, this was not uncovered until the 1099s were issued, often as long as a year after the payment was made. This causes a lot of extra work for the accounts payable staff—and usually at a time of year when they are already overworked.

Even more distressing to accounts payable was the fact that if the contractor had not done any additional work for the company, tracking it down and getting the corrected information was often difficult. Recognizing the problems inherent with that approach, the IRS has come up with a program that allows this information to be checked throughout the year. It is referred to as the TIN Matching program.

The TIN Matching program allows companies to submit names with TINs for verification purposes throughout the year. The turnaround time is fairly quick. It is recommended, from a control point of view, that companies make use of the program throughout the year. In fact, a few companies are starting to withhold payments from independent contractors until they have received positive verification of a match from the IRS. If the accounts payable department and purchasing have their work flow coordinated, it is possible to do this without the contractor in question ever knowing that the verification was done, and payments can be made according to the normal disbursement cycle.

The beauty of this approach is that it allows the company to verify information while it still has a captive audience—the contractor who wants to get paid. Once the contractor has received that payment, the leverage goes away. Use of the IRS TIN Matching program is fast becoming a best practice in the 1099 world. You must register to use the program.

## B NOTICES

If you've ever received a boatload of B Notices (a "B" Notice is a backup withholding notice that you get when there is an er-

ror on submitted 1099 information), you probably are a big fan of the TIN Matching program or got on the Internet the moment you read about it. B Notices are a big pain; they are costly and a waste of valuable time the accounts payable staff could be spending doing something that adds value. But they must be addressed. They are the notices sent whenever the IRS identifies errors on the payer's annual returns. The processes of either getting the information corrected or proving to the IRS that you have fulfilled your verification obligations are cumbersome.

The best approach is not to make a mistake in the first place, which is why the TIN Matching program has so much appeal. These notices are likely to come in either March or October, depending largely on when you filed your returns and if filing extensions were obtained to extend your deadlines.

## NONRESIDENT ALIENS

The IRS is interested in all payments made to potential taxpayers, not just those residing in the United States. In light of the terrorist attacks of 9/11, increased scrutiny has been placed on payments made to nonresident aliens. The reporting of this income is on 1042 and 1042S (to the recipient of the income and the government). To be perfectly candid about this issue, many companies were completely ignorant of this requirement. This can be a huge issue for colleges and universities that make extensive use of visiting professors and lecturers from outside the United States.

Recognizing that so many organizations were not in compliance with these regulations, the IRS ran a voluntary compliance program through the end of 2005. This provided a safe haven for noncomplying entities to get in compliance without paying a penalty. If the IRS audits your firm and finds out it is not reporting income paid to nonresident aliens,

your organization will be subject to a fine, in addition to having to pay any missing taxes.

## W-8

A W-8 is a form, similar to a W-9, that organizations must get from any nonresident alien to whom it makes a payment. There is a 30% withholding requirement associated with these payments. This is different than the withholdings on W-9 income, where, by providing correct information, the organization does not have to withhold anything. Additionally, the rate is different.

Although these laws have been around for some time, it is only recently that they have reached the high profile that they currently enjoy. The rules surrounding this reporting are a bit complicated. If your firm is not currently reporting this income correctly, once again, your CEO should not be certifying that the company is in compliance with all state and federal regulations.

## OFAC AND FTO REPORTING

While not specifically related to independent contractor reporting, all U.S. organizations are expressly forbidden from making payments of any kind (even if they are for legitimate business reasons) to terrorist organizations. Now, before you start rolling your eyes, consider that many have completely innocuous sounding names and that the list of SDNs (Specially Designated Nationals) and Blocked Persons published by the Office of Foreign Asset Control (OFAC) is, at this writing, 210 pages long. Each page has between 50 and 100 entries, and the list is updated each week. Add to this the 40 foreign terrorist organizations (FTOs) or so on the Treasury's list, and you can see that the list is substantial.

Companies should run all their payments against these

lists to ensure they are not paying any organization that is on the list. Many have very legitimate-sounding names. If you get a hit, verify the address and/or call OFAC for further guidance.

The OFAC list is updated weekly, and companies should download these updates on a regular basis. The list can be found at www.treas.gov/offices/enforcement/ofac/sdn/, although the Web site occasionally changes. If this link is not live when you try it, search around the Treasury's site to find its new location.

## P-CARD AND QPCA REPORTING

As previously mentioned, payments made on p-cards must be included in all 1099 reporting where applicable payments are made. This is another gray area for many companies, even those that think they've got this problem licked. Here's why. When employees use their T&E card or p-card for a purchase related to the company's business, they often do not realize that they are paying someone who should get a 1099.

The most common issue is the matter of hotels. Although the employee may be staying in one of the big chains and think everything is fine from a 1099 reporting basis (actually, they probably never think about 1099s), there could be a problem. Many hotels are actually franchises with the individual units owned either by individuals or limited liability partnership (LLP).

Some companies get around this problem (they think) by prohibiting payment with a credit card to any entity that must get a 1099. However, as in the hotel example, many do not realize that they are paying a 1099-reportable entity.

The quick-fix answer is to look to the credit card companies for this information, and, in fact, there has been some movement in this regard. Under the final rules, a payment card organization (e.g., Visa, MasterCard, American Express)

may enter into a five-year agreement with the IRS to solicit and validate merchant TINs on behalf of the cardholders in their organizations.

If a card organization is a Qualified Purchase Card Agent (QPCA), and if its merchants are "qualified payees" (have provided a valid name and TIN), no backup withholding is ever required by the cardholders when doing business with those merchants. At this point (early October 2005), it is believed that the big three have applied, but final approval has not been given. This is an issue that any organization that permits credit card payments on its behalf (including those that allow employees to use their own cards and then solicit reimbursement from their company) needs to follow closely.

## ADDITIONAL READING

The following publications are available online should you wish additional information on these topics:

- IRS Publication 15-A (1/2005), Employer's Supplemental Tax Guide
- Supplement to Publication 15 (Circular E), Employer's Tax Guide
- QPCA (*www.napcp.org/napcp/napcp.nsf/NavigationAll/QPCA+Revenue+Procedures?OpenDocument)*

# 10

# Sales and Use Tax

Anyone with responsibility for monitoring and reporting their organization's sales and use tax obligations knows that it is an extremely complicated task. It's hard to get it right, and rarely is it a top priority at a company. While only public companies have to worry about Sarbanes-Oxley compliance, all organizations need to be concerned about what's going on with sales and use tax compliance.

The reason is that virtually all states are looking for ways to generate revenue. And what better way to do that than to find a company negligent in the reporting (and payment) of its sales and use tax obligations. So the states are aggressively pursuing this income, sometimes with the assistance of third-party auditors working on a contingency basis at the same time as companies have the Sarbanes-Oxley Act breathing down their necks. This income is supplemented by penalties and fines of the organizations found not to be in compliance.

There's one other point to be cognizant of: Some of these auditors work for more than one state, and once they've found that you have a problem in one state, you become an easy target for them and every state they work for.

## PROBLEMS WITH PROPER TAX COMPLIANCE

Currently, 45 states along with the District of Columbia charge sales and/or use tax. In each state there can be hundreds of different taxing entities. There are believed to be approximately 10,000 taxing organizations within the United States. What is taxable in one is not necessarily taxable in the next. In any given year there are probably between 500 and 1,000 individual changes to the rules.

For practical purposes, sales and use tax can include almost any type of transactional tax, fee, or surcharge. Accurately calculating the amount owed is a precise and difficult calculation. Therefore, getting it right is not as simple as the uninitiated might think. To be frank, unless a company makes a concerted effort to hire professionals to handle this task, the odds are high that it is not being done correctly.

The term *sales tax* means different things to different people. Your definition may be narrow or broad, but in the world of tax compliance today, sales and use taxes include practically any type of transactional tax, fee, or surcharge. Accurately calculating the amount of sales or use tax owed, and accurately determining the party to which it is owed, is not as simple as it may appear at first glance. The factors affecting the calculation and filing of a sales and use tax include:

- Determining nexus, situs, and the proper taxing jurisdiction
- Identifying the profit or nonprofit status of the entity from which the tax is being collected
- Identifying special tax status situations, including amnesty or tax holiday periods
- Reviewing other relevant rulings

And, of course, the forms that must be filed are not the same for each taxing jurisdiction. Just keeping track of the correct form can be a daunting task. Filing the correct, latest-

version forms for the correct amounts is also a monumental task.

Even with that, the taxation cycle is not complete once the form is filed and payment made. The ability to track and reproduce the data-gathering and decision-making process that took place to fill out the form is a crucial requirement. Documentation is key in the process. A transparent, accessible audit trail should be a clear goal.

## REALLY BAD PRACTICE

Hopefully, by now you are convinced that keeping track of sales and use tax obligation is a full-time job. Yet some companies regularly rely on the memories of the clerks in accounts payable to ensure that the correct taxes get paid. Many do an amazingly good job despite the ludicrousness of the situation. A company that takes this approach will not be deemed to have appropriate internal controls for sales and use tax. What's more—and this is something that you can get management's attention with—by not accurately calculating their sales and use tax, a company may actually be overpaying their obligations.

## DOCUMENTED PROCEDURES

Documented procedures for your sales and use tax function will help you in several ways. First, it will fulfill the documentation requirements for Sarbanes-Oxley. In many organizations, the sales and use tax policy and procedures manual was written five, ten, or more years ago and never looked at again. Dust it off and take a look at it with an eye toward:

- Updating it with current procedures
- Incorporating controls into the process where they are lacking
- Sharing it with all affected parties for their input and later use

The last good reason to do this has nothing to do with Sarbanes-Oxley. Should your organization be selected for a Sales and Use Tax audit by a particular state and it is found that you missed payments, you may be able to avoid penalties by showing, through your manual, that you had demonstrated good faith in complying with the law. If, however, your manual is ten years old and has never been updated, and the auditors can't find it on their visit, your good faith claim will be extremely weakened.

## AUDIT TRAILS

The ability to track your transactions and decisions regarding sales and use tax is important when it comes to both Sarbanes-Oxley compliance and dealing with a state audit. The paper trail is important. To be deemed in compliance with the internal control features of the Act, establish a process that makes the audit trail for your sales and use tax decisions readily available.

## SOFTWARE OR FORMS

Typically, sales and use tax compliance is handled either through forms, sometimes referred to as a *forms library,* or through a more sophisticated software, sometimes called a *compliance engine.* To determine which is right for your organization, several matters need to be addressed. Clearly, forms will work in the simpler instance, while the compliance software is the preferred approach when the matter is more complicated. Where should you draw the line?

If you are involved with multiple nexuses and situses, have multiple locations that input data and calculate tax, or have minimal information technology (IT) resources, the forms approach might not work. If you've been through an audit that has not gone well in the past, the forms approach

might not be the best choice. Additionally, some experts recommend that if you have a nexus in Alabama, California, Colorado, Georgia, Louisiana, New Mexico, or Texas, the forms might not work.

Some of the software on the market will produce a Sarbanes-Oxley compliance profile as part of its output. If this feature is available in the software that you use, it is recommended that you print the report regardless of whether you have formal Sarbanes-Oxley requirements.

## STREAMLINED SALES TAX PROJECT: NOT A SOLUTION

Many reading this are aware that there is an initiative to streamline the whole sales tax process called the Streamlined Sales Tax Project. It is an initiative created by state governments, with input from local governments and the private sector, to simplify and modernize sales and use tax collection and administration. The Project's proposals include tax law simplifications, more efficient administrative procedures, and emerging technologies to substantially reduce the burden of tax collection. The Project's proposals are focused on improving sales and use tax administration systems for all types of commerce.

If your sales and use processes are not up to snuff and you are counting on this streamline project to solve your problems, you are in for a rude awakening. The Project was first started in March 2000, and while the group has made some significant strides, no one is predicting that sales and use tax administration will be simplified tremendously. For starters, not all the states are involved. Three are not considered to be involved, and a large number are still waiting for their local legislatures to approve their participation.

The goals of the group are far reaching. They include:

- Uniform definitions within tax laws
- Rate simplification

- State-level tax administration of all state and local sales and use taxes
- Uniform sourcing rules
- Simplified exemption administration for use- and entity-based exemptions
- Uniform audit procedures
- State funding of the system

The Project proposes that states change their sales and use tax laws to conform to the simplifications as proposed by the Project. It is also attempting to get the states to amend or modify their sales and use tax laws to achieve the simplifications and uniformity required by the participating states working together. If you are dubious that the group will be successful, no matter how worthwhile its goals, you are part of a large crowd. It is highly unlikely that it will be the answer to your prayers in the short term.

# PART IV

## Overall Guidelines to Conform

# 11

# Fraud Prevention Controls

Rarely does a fraud occur in the corporate world that does not signal a serious breakdown in internal controls—that someone was asleep at the switch. Alternatively, it could mean that the controls didn't break down, but that they were so weak to start with the only surprise is that fraud didn't occur sooner. Thanks to the Association of Certified Fraud Examiners (ACFE), we have some statistics on corporate fraud. By providing an overview of what actually goes on in the corporate world, executives will be able to identify potential similar situations in their own organizations.

## REPORT TO THE NATION: 2004

The ACFE calls its report the Report to the Nation. It has been produced several times; the prior report was in 2002. Cash misappropriations accounted for 87% of the frauds studied. These fell into three categories:

1. **Fraudulent Disbursements**, in which the perpetrator causes his organization to disburse funds through some trick or device. Common examples include submitting false invoices or forging company checks.

2. **Skimming**, in which cash is stolen from an organization before it is recorded on the organization's books and records.
3. **Cash Larceny**, in which cash is stolen from an organization after it has been recorded on the organization's books and records.

The definitions of these types of fraud came directly from the Report.

## FRAUDULENT DISBURSEMENTS

While Sarbanes-Oxley concerns all sorts of fraud, the type that is most frequently related to accounts payable is also the most common type of fraud. Approximately three fourths of the cash frauds (or two thirds of all frauds) in the study involved some form of fraudulent disbursement. Unfortunately, these were also the schemes that involved the highest median loss, at $125,000. It is instructive to know how these schemes were further broken down.

The following information from the Report includes the percentage of frauds that fell into the category along with the median reported loss. You will note that the numbers exceed 100%. This is because some frauds fall into more than one category:

- **Billing Schemes**, in which a fraudster causes the victim organization to issue a payment by submitting invoices for fictitious goods or services, inflated invoices, or invoices for personal purchases—52.1% ($140,000)
- **Check Tampering**, in which the perpetrator converts an organization's funds by forging or altering a check on one of the organization's bank accounts, or steals a check the organization has legitimately issued to another payee—31.3% ($155,000)

- **Expense Reimbursement Schemes**, in which an employee makes a claim for reimbursement of fictitious or inflated business expenses—22.1% ($92,000)
- **Payroll Schemes**, in which an employee causes the victim organization to issue a payment by making false claims for compensation—19.6% ($90,000)
- **Register Disbursement Schemes**, in which an employee makes false entries on a cash register to conceal the fraudulent removal of currency—4.3% ($18,000)

Not only do the frauds that are most likely to occur relate to accounts payable, they also have the largest losses associated with them.

## UNCOVERING FRAUD

Most companies would like to believe that their own internal processes are strong enough to catch a disbursement fraud before the money goes out the door. Unfortunately, that is not always the case. In fact, of the frauds that were uncovered after the fact, internal controls were not a key factor in detecting the fraud. When it comes to large cases (i.e., those over $1 million), the internal controls fell down on the job big time.

What is truly frustrating, as the data in Exhibit 11.1 demonstrates, is that uncovering these crimes is often a matter of luck, or rather bad luck, on the part of the crook. Roughly 40% of all cases were discovered, not because of any grand work on the part company executives but rather because of a tip. When you combine this with the 18% of cases that are discovered by accident, the matter gets more disheartening. By the way, once again the numbers in Exhibit 11.1 will exceed 100% as sometimes more than one technique was associated with the discovery of the fraud.

**Exhibit 11.1 How Fraud Is Uncovered**

| | Percent of Cases | |
|---|---|---|
| | Initial | Million $ Cases |
| Tip | 39.6 | 42.6 |
| Internal Audit | 23.8 | 24.6 |
| By Accident | 21.3 | 18.0 |
| Internal Controls | 18.4 | 8.2 |
| External Audit | 10.9 | 16.4 |
| Notified by Police | 1.0 | 1.6 |

## WHO COMMITS THESE CRIMES?

The traditional response to the question of who commits fraud against a company was a long-term trusted male employee. That profile still fits, although just barely. The long-term and the trusted employee demographics still apply. By a very narrow margin, males are more likely to steal, with 52.9% of the frauds being perpetrated by males.

You will note, from the numbers below, that fraud tends to be carried out by those who've been with the company for some time. In fact, only a little over one quarter of the frauds are committed by employees who've been with their organizations less than two years.

| Tenure | Percent |
|---|---|
| <1 year | (6.7%) |
| 1–2 years | (20.0%) |
| 3–5 years | (27.0%) |
| 6–10 years | (22.8%) |
| >10 years | (23.5%) |

## RECOVERY

The recovery of stolen funds, according to the ACFE, is abysmal. Only 22% of companies recovered 100% of their loses, and one third of those recoveries came from insurance coverage. Thus, to use an old homily, an ounce of prevention is worth a pound of cure. The best option for any organization is to prevent the fraud in the first place.

The complete ACFE 2004 Report to the Nation can be seen at *http://www.cfenet.com/pdfs/2004RttN.pdf.*

## EMPLOYEE FRAUD

What the ACFE data demonstrates is that there is a need for strong internal controls. Here are some things that can be done to make it difficult for those few employees who would actually defraud their employers:

- **Establish an anonymous hotline.** There are two good reasons to do this. First, it is required by Sarbanes-Oxley. But there's an even better reason. In reviewing the data above, an extremely high percentage came from tips. Make it easy and anonymous for employees to come forward.
- **Make sure that you have the appropriate segregation of duties.** Appendix B contains a list of some of those segregations. While this will not prevent fraud, it will make it more difficult for potential crooks. With proper segregation of duties, certain frauds become impossible to commit without collusion. Unfortunately, this just reduces the incidence of these crimes because, occasionally, employees do get together to defraud their employers.
- **Insist that employees take their vacation time.** This is often when an ongoing employee fraud comes to light. Be

suspicious of the employee who goes several years without ever taking a day off. The following will be hard to do if your firm offers only two weeks' vacation. Some banks require that employees take at least two consecutive weeks off. It is believed that all frauds will be discovered within that time frame. If it is reasonable to make this a requirement, do so. If it is not, consider rotating employees off their normal assignments for cross-training purposes.

- **Put Standard Industrial Classification (SIC) code limitations on p-cards.** This needs to be done with care and will prevent employees from making certain unauthorized purchases. However, be aware that the SIC code assignment is not perfect and you could end up creating a few problems.
- **Have a thorough investigation process before hiring a new employee.** Check references and verify former employment. While this will not completely prevent fraud, it will help when it comes to filing a claim in case of a loss. By being able to prove that you took reasonable care in your hiring practices, you will have less trouble with the insurance company when filing the claim.

These issues all address your internal control structure.

## VENDOR FRAUD

Fraudulent invoices are a serious issue for corporate America. New vendors should be verified. Have a process in place before a vendor is entered into the master vendor file. A form should be filled out and a W-9 obtained. The form should have all relevant data about the vendor. Ideally, it should be submitted by one person and approved by a second. When it arrives in accounts payable (or wherever the master vendor file function resides), some additional verification should be done.

When verifying the information provided by the vendor, do not use that data. For example, instead of using the phone number on the application (it's just too easy to provide an incorrect number), get on the Internet and find the number. Check out the address as well. Is it the same? If not, is there a good reason? For example, a company may have a "Pay To" address that is actually its lockbox.

Here's a real simple check that should take less than 60 seconds. Get on the Internet and go to *www.411.com*. Click on the link for reverse phone lookup. Now, get out the information provided by the potential vendor and enter the phone number. The odds are high that you will not get a hit. But if it turns out to be someone's residence, you know you've got a problem.

**W-9**

Some accounts payable departments have trouble getting W-9s from their independent contractors. Between Sarbanes-Oxley and the heightened IRS scrutiny, this should be a no-brainer. However, in some cases there still is reluctance on the part of purchasing to ask suppliers for these documents. It is a control issue for three reasons:

1. It is needed in order to correctly report income, and the company could be liable for the taxes owed by the contractor if it is not reported correctly.
2. You are not in compliance with IRS statutes if W-9s are not obtained and 1099s not issued in an appropriate manner.
3. By getting the W-9 and verifying the TIN (tax identification number)/name match, you are confirming that the vendor is a legitimate entity.

*Note:* While you've confirmed that the vendor is legitimate, it does not mean necessarily that the invoices it sends your

firm are legitimate. That should be addressed in your invoice-processing standards and procedures.

From a control point, every company should have a "No TIN, No Payment" policy. If a vendor refuses to provide the TIN, simply withhold the appropriate taxes and pay it, if management insists. This will not win you any popularity contests, but one has to wonder why a vendor would refuse to provide its TIN.

## SMALL-DOLLAR INVOICE FRAUD

If you work in an organization of any size, you are probably bombarded with invoices for copier toner, yellow pages ads, and a variety of other items never ordered by anyone in your organization. Invariably, you will find that these invoices are for common items at highly inflated prices. Sometimes the goods will even be delivered to your organization and they will be of extremely low quality. This, of course, makes it a little more difficult because when accounts payable goes to do the three-way match, there is a receiving document. Of course, they can never figure out who ordered the goods. Unfortunately, in the case of toner and copier paper, the goods sometimes get mixed in with the company's supplies and used—and paid for.

The control issue here is to have some sort of a tracking system for identifying who ordered goods when invoices come into accounts payable without a PO number. Some companies take the aggressive step of returning such invoices to the supplier. They have a policy that states that all invoices must either have a valid PO number or the name of the person who ordered the goods. Others take an even harsher stance. They insist on a PO number and demand that the supplier go back to the person who ordered the item and obtain one. While these practices work well in getting rid of fraudulent invoices, they do not necessarily make for good vendor relations.

From a practical standpoint, it might seem that it would be reasonable to occasionally pay for these goods rather than invest a lot in setting up controls to avoid paying for them. The problem with that philosophy is that once you pay, you go on the sucker list and will continue to get billed for inferior products not ordered.

## CHECK FRAUD

As discussed earlier in this chapter and in Chapter 4, check fraud is a huge problem in the United States. If good controls are used along the entire check-processing cycle, you will have diminished, but not eliminated, the potential for check fraud. To be perfectly honest, it is unlikely that the threat will ever be completely eradicated. It is an ongoing battle. Every time the corporate world comes up with a solution to a particular form of check fraud, the thieves move on and come up with another variation.

From a protection standpoint and as a control issue, Positive Pay is now considered to be an essential tool in the fight against check fraud. While the number of companies using the many varieties of Positive Pay is growing, there are still a number who have refused to make the move. That is not wise.

Inactive bank accounts should be closed and any remaining check stock destroyed. This is not likely to be a favorite task among your staff. When we say destroyed, we are not talking about just throwing the checks in the garbage. They should be shredded. This is another reason why companies are moving to laser checks: there is no check stock to shred when accounts are closed.

While there is some fraud associated with electronic payments, it is, at least at this point, much less common than check fraud. Thus, a move to the electronic world can help in this regard.

Segregation of duties should be strictly adhered to when allocating responsibilities for the various functions in the check-production cycle. Each person should have his or her own password and user ID for any systems used. It is considered a weak control to allow employees to share passwords, and it will get your organization in trouble during your Sarbanes-Oxley audit.

## DEMAND DRAFT FRAUD

This little-known payment device was designed to accommodate legitimate telemarketers who receive authorization from consumers to take money out of the consumer's checking account. This payment alternative is very similar to writing a check except that it requires no signature. In place of the authorized signature on the check, the words "signature not required, your depositor has authorized this payment to payee" or similar wording is used. Since the check-processing areas at banks are completely automated, the signature line is virtually never checked.

In the telemarketer example, this is a creative payment approach that enables the transaction to proceed smoothly. Demand drafts are also sometimes referred to as *remotely created checks*. You can see that there is potential for check fraud in this arrangement, but then any time a check is used for payment, there is also the possibility for abuse. Once the thief has the account number and the name of the account owner, check fraud is merely a matter of conscience, opportunity, and a few dollars for technology.

An outfit called Qchex.com dramatically lowers the bar for entry. No longer is it necessary to have those few dollars for technology. It's not even necessary to know the name of the account holder, only the account number and the routing code. Accounts can be opened by individuals, merchants who want to accept checks, and businesses and institutions who

want to send checks to suppliers or receive payments from customers.

Unfortunately, it does not verify that the person issuing the check is the actual account holder.

Qchex would like you to register all your organization's bank accounts with them to prevent someone else from registering them under their own name. To me, that just seems like positive reinforcement for bad behavior. Better to monitor the activity on your bank accounts daily as part of your cash-flow monitoring and control points.

## CONCLUDING THOUGHTS

Fraud is a serious problem for all organizations. Often, it indicates that internal controls were less than they should be. While Sarbanes-Oxley has made internal controls a key focal point, the losses that can accrue because of these frauds is a serious consideration. As the numbers from the ACFE demonstrate, successful frauds typically involve such serious amounts of money that the corporate world is well advised to take as many precautions as it can to prevent them.

# 12

# Documentation Needed to Conform to the Act

After working in accounts payable for any amount of time, most professionals realize that concepts like documentation, clear audit trail, proper authorization, written policies and procedures, and records retention policy are important. Unfortunately, recognizing that these concepts are critical does not mean that they find their way onto the high-priority list in many organizations. Like getting your oil changed every three months and going for an annual physical, sometimes these tasks get pushed aside in favor of more pressing issues. Sarbanes-Oxley and some of the accounting scandals have now made these a top priority again.

## BOARD AUTHORIZATIONS

In many organizations, who does what just evolved. For most tasks, this is fine. But for others, it is not. Typically, anything that commits the organization may require a board authorization. This may include spending, wiring money, signing checks, moving funds between bank accounts, and who gets a purchase card (p-card).

Anything that requires board authorization needs to be reviewed periodically. In addition to making sure that the person named in the authorization is still doing the task, the requirements for further delegations need to be reviewed. This is one reason that most delegations refer to titles and not individuals' names.

Do the further delegations need to be documented in writing? Do they need to be filed or submitted somewhere? These authorizations should be included in the policy and procedures manual.

## FLOWCHART

Most experts recommend that the department's operations be flowcharted as part of the Sarbanes-Oxley compliance process. This is a good idea even without the Act. It forces the discipline of reviewing the ongoing process and documenting it. This flowchart should not be completed in a vacuum. It needs to accurately represent the work flow of the department, not what the manager or executives would like the work flow to look like.

It should be completed with input from the individuals who do the work. When it is completed, someone should verify that what's in the chart is how the work actually is done. This is a great opportunity for the manager who believes some of the group's processes are more cumbersome than they need to be.

Once the chart is completed, it can be reviewed for two reasons:

1. To ensure that the appropriate controls are in place
2. To determine whether there are any processes on the chart that are unnecessary

This last analysis is key to getting rid of non-value-added steps. There is a good reason for eliminating these extraneous steps. They can actually weaken controls.

Here's an example: In some organizations, all hand-signed checks must be reviewed by an assistant treasurer before they are mailed. At the company in question, the checks often sit on this individual's desk for two or three days before he or she releases them. While ostentatiously this is a review process, the real reason for the review is that this is how the assistant treasurer monitors what other departments are spending—something that is none of his professional business. If the appropriate up-front controls are in place, this review adds nothing but time and additional risk (someone could take the checks from his frequently unoccupied office) to the process. By including this step in the process, it highlights the inefficiency.

To further highlight the process, include estimated time frames with each step. This will become useful in those situations where management is demanding (often rightly so) that the procure-to-pay cycle be accelerated. Simply take out the flowchart, with the time frames noted, and ask where the time should be cut from the process.

One of the biggest bottlenecks in many organizations is the invoice-approval process. It is not unusual to see two thirds or more of the cycle time being allotted to getting the invoice approved. This is especially true if electronic invoicing, imaging, and work flow are not being used. The flowchart will highlight these inefficiencies. Accounts payable professionals can use this chart to back their recommendations for imaging, work flow, and/or electronic invoicing.

## AUDIT TRAILS

The audit trail feature available when invoices are moved electronically eliminates a lot of the silly problems that have gone on for years with that process. No longer can purchasing claim that it never received an invoice when it has been sitting in the department for three weeks. Similarly, accounts payable

can't stick an invoice in interoffice mail and then claim it was mailed three weeks ago (of course, that rarely happens). The escalating approval functions built into some of the work flow software further enhance the ability to monitor and cut processing time.

Audit trails are important across all functions in accounts payable. Being able to document decisions regarding sales and use tax, unclaimed property, and W-9s and 1042s are just the beginning of why documentation is important. While your accountants may want the audit trail information, government auditors will insist on it should you come up for an audit by one of these groups or if you are charged a penalty for failure to comply with certain regulations. The audit trail will be important in avoiding fines, as it will demonstrate your intent.

## RECORDS RETENTION

Records retention policies go hand in hand with audit trails. You can't have a decent audit trail if records can't be retrieved. In many organizations this is a much bigger problem than most would expect. Even the very largest companies, the ones that you would expect to be able to put their hand on any record they could conceivably need at a moment's notice, run into trouble on this one. While electronic initiatives will take care of some of the control points surrounding records retention, this will happen only if the appropriate control points are properly addressed. This translates into proper indexing and storage routines.

When *Accounts Payable Now & Tomorrow* polled a group of its readers about their records retention policies, over one quarter of them indicated that they had improved those policies in light of Sarbanes-Oxley.

Readers should make sure that their record retention policies conform to IRS and other governmental agency require-

ments. Some documents that you might want to refer to in this regard are:

- For overall retention of books and records information, IRS Revenue Procedure 97-22
- For information about electronic information, IRS Revenue Procedure 98-25

Being able to access these records will become very important should you end up with sales and use tax or unclaimed property auditors in your office.

When a new accounting system is installed or, for that matter, when the existing one is upgraded, care must be taken to ensure that no information is lost.

As a word of caution, most duplicate payment experts see a bonanza for themselves whenever a new accounting system is installed. This is because there is typically a breakdown in controls and more items than normal get paid twice. Recognizing that this may occur is the first preventative step that companies can take. Identifying those potential duplicates before they go out the door is the next.

## RECORDS RETENTION IN MERGED ENTITIES

If the organization has acquired (or merged with) numerous other groups over the last few years, the problem is likely to be much bigger than you would believe. When groups merge and the accounting systems are not the same, as they rarely are, humongous problems ensue. Either they both keep operating using their existing accounting systems or the newly acquired company is compelled to use the accounting system of the acquirer. Both situations can result in messes, with audit trails decimated, payment histories lost, and requisite records effectively falling into a black hole.

The problem is magnified over the years when multiple entities with different accounting systems are merged. It is not

unusual to hear of megacompanies using six or seven different accounting systems. And you can imagine what happens, from a records retention standpoint, when that larger entity decides to integrate all its subsidiaries into one accounting system.

## POLICY AND PROCEDURES MANUAL

Like the semiannual visit to the dentist, most professionals know they should have a policy and procedures manual, but only a small percentage actually do. Even in those organizations that finally do get one put together, it is rarely updated. While Sarbanes-Oxley doesn't actually mandate a policy and procedures manual for accounts payable, it's hard to visualize many situations where one would be considered in compliance without one.

If you've completed that aforementioned flowchart, a good portion of the work producing the manual has been completed. The task at hand is converting that diagram into words, keeping it updated, and making sure it reflects what actually goes on in the department.

What sometimes happens, with both the manual and the flowchart, is that over time, processes drift from the documented policy to something else. Unfortunately, that something else often introduces weaknesses and control points into the process. Sometimes, in an effort to speed up the work, steps are omitted from the process or the segregation of duties requirements are voided.

The policy and procedures manual should be shared with all affected parties. This means that, for example, purchasing should have input into and be given the final version of all sections that affect it. It is meaningless to write a policy that will require a three-day turnaround time of invoices if interoffice mail is used and it is slow. Similarly, if the purchasing manager is required to approve all invoices and he travels ex-

tensively, a lengthy approval time will be required unless electronic mechanisms are used or the board authorization for spending approvals can be further delegated.

Many organizations now post their accounts payable policy and procedures manual on their company intranet sites. This makes the information available to anyone who needs it, makes updating it relatively easy, and keeps it on the forefront of everyone's mind. It also makes it easy to refer people with questions to the manual rather than have accounts payable answer every question. From a control standpoint, this is recommended. It forces everyone to use the same source document for procedures rather than relying on one individual's memory, which may or may not be accurate.

Readers should be aware that having a policy and procedures manual can come back to haunt them if the staff does not adhere to it. By posting it on the intranet, or making it readily available using some other mechanism, the department is announcing its requirements. It makes it relatively easy to uncover situations where the policy is not adhered to by the accounts payable staff.

**An Ongoing Project**

Very little in life remains static, and accounts payable is no exception. Even if you think you have policies and procedures exactly the way you like them, circumstances outside the control of the department may force a change. A move to a new accounting system, starting to use electronic payment alternatives, a demand by a key supplier, a physical move by a group within the organization, a new CFO, or any one of a thousand other things can cause the department to need to implement change.

The very best manuals are updated every time a change to the procedures is made. This is one of the benefits of posting the manual online instead of printing hard copies. Of course,

this is probably not realistic in most organizations. At least once a year the manual should be reviewed and updated. This is also a good time to ensure that the procedures detailed in the manual are actually being followed in the department. You will be surprised to find how often they are not.

**Help from the Manual**

Accounts payable departments in many organizations have trouble with rush checks. These are checks drawn outside the normal check-production cycle to accommodate emergencies or unforeseen expenditures. In most organizations it is not possible to get completely away from these, especially if checks are run only once a week or twice a month. However, the process is often abused, to the detriment of the organization's internal controls.

In many cases, rush checks are requested over and over again by individuals who are negligent in their own responsibilities. They don't approve an invoice in a timely manner, and then, when the vendor is screaming, they demand that accounts payable issue a rush check. While most accounts payable departments are willing to help out once in a while, they grow weary of bailing out the same individuals over and over again. Yet, in some organizations, management refuses to back them in their request that rush checks be extremely limited.

This is where the policy and procedures manual can come to the rescue, if used judiciously and correctly. The first thing to do is to make sure that the check-production schedule and cycle is documented in the manual. Then make sure it is shared with all affected parties and/or posted on the intranet.

It wouldn't hurt if you also get the external auditors to make some suggestions regarding the inappropriateness of rush checks and their impact on internal controls. Then, when the next request comes, as you know it will, bring up the

posted manual and your desire to not do anything that could subject the company to problems with its Sarbanes-Oxley audit. Will it work? It depends on the corporate culture. And even if it doesn't work, I'm willing to bet that the individual requesting the check, in most instances, will come back less frequently. The key words here are "breakdown in internal controls" and "Sarbanes-Oxley audit."

## A WRITTEN T&E POLICY

The company's travel and entertainment (T&E) policy can be part of the accounts payable manual, say a separate chapter, or it can be a stand-alone document. It is the information that will be referenced by the largest numbers of employees outside accounts payable. Ideally, it will be posted on the organization's intranet, and employees with questions should be directed to the document. As with other parts of the manual, it is not fair, nor is it a good practice, to rely on the memory of someone in accounts payable for information.

Even if the rest of the accounts payable policy and procedures manual is not endorsed by senior management, the T&E policy should be. After all, a large number of employees will have to live by it. Ideally, the policy will be issued by the CEO or CFO or some other high-level executive. This is especially true in organizations that are undergoing a cultural shift as management moves toward the enforcement of stricter adherence across all departmental lines. Copies of the policy should be sent to every employee, or it should be posted on the organization's intranet site.

Readers are reminded that T&E is probably one of the functions that has undergone the biggest changes due to the passage of Sarbanes-Oxley. In fact, close to 60% of a small group of readers polled by *Accounts Payable Now & Tomorrow* indicated that they had revised their T&E policies and procedures because of the Act. Thus, it is important that informa-

tion be shared with employees aggressively. There's a new sheriff in town, and T&E will likely be the suspect that must change the most.

## OTHER INFORMATION THAT SHOULD BE SHARED WITH ALL EMPLOYEES

One of the ways that accounts payable can limit the fallout from newer stringent policies in the light of Sarbanes-Oxley is to share that vital information with all affected parties. Now, let's be realistic. Most employees have little interest in the information emanating from accounts payable. So, it is unrealistic to expect that if you provide a big manual everyone will read it. What's more, even if you do, how much will they remember? Putting it online is a good way to address the problem. Then simply share the location of the manual and perhaps a few key points that will benefit them or that numerous employees continually get wrong.

The key to sharing accounts payable information is to keep it as short as possible to ensure that your crucial information will get read. Here's a list of some of the things that you might want to share to avoid conflicts and strengthen controls:

- Check-production schedule and cutoff dates
- Policy regarding rush checks
- T&E policy changes that are likely to cause complaints
- Anything unique to your organization that may result in issues with numerous employees

## CONCLUDING THOUGHTS

Documentation, record retention, and audit trails are not issues normally associated with accounts payable. However, from a managerial point of view, they need to be taken into

account any time a new process is introduced. As accounts payable continues to transform itself from a purely transactional organization into one that is analytical and adds value, these concerns cannot be ignored. What was once often overlooked needs now to be an integral part of the process.

# 13

# Overall Guidelines for Conforming to the Act

The following discussion is applicable not only to organizations looking to be in compliance with the Sarbanes-Oxley Act, but also those that are concerned about having strong internal controls. This is especially important in accounts payable because, as Willy Sutton says about banks, "It's where the money is." The following practices will help accounts payable departments strengthen controls and improve compliance.

## SEGREGATION OF DUTIES

In order to perpetrate a fraud through accounts payable, it is frequently necessary to have access to more than one function. For example, a person would have to have access to the check stock and the facsimile signer. Thus, one of the easiest ways to prevent fraud is to assign responsibilities in such a manner to minimize this risk. Depending on the size of the department, it may be necessary to work with another group to achieve this goal.

Alternatively, close scrutiny on a regular basis of any person with multiple conflicting responsibilities is recommended. Companies sometimes get lulled into a false sense of security because the particular employee with multiple conflicting responsibilities has been with them a long time. This is a mistake, as most frauds are committed by long-time trusted employees.

## EMPLOY REASONABLE HIRING AND BACKGROUND-CHECKING PROCESSES

Because the employees in accounts payable are sometimes viewed as clerks, not much consideration goes into the hiring or background-checking process. This can be a huge mistake, as the employees in the department regularly come in contact with or have access to the organization's lifeblood—its money.

Should a fraud occur on your watch and be perpetrated by someone on the accounts payable staff, the manager should be able to demonstrate that reasonable care was exercised in hiring that person. This is not to say that reference checks will necessarily uncover a potential thief, but they will cover the bases for the manager who made the unfortunate decision to hire the individual. Often, just a few phone calls will uncover enough information to raise a red flag.

The phone calls may not uncover a potential thief, even if the person providing the reference has knowledge of prior wrongdoings. The reason for this is that many companies provide references verifying only that the individual worked for them for a particular period. Fear of lawsuits due to unfavorable references has forced many to set a corporate policy of just providing the equivalent of name, rank, and serial number. This is unfortunate because often employees who deserve sterling references are hung out to dry due to these policies.

## ESTABLISH INTERNAL CONTROLS THROUGHOUT THE ACCOUNTS PAYABLE PROCESS

Two problems that have plagued accounts payable departments everywhere are fraud and duplicate payments. The two are often mentioned in the same breath because the controls to prevent the latter also help with the former. Although this is starting to change, many organizations often looked at their accounts payable operations as a bunch of clerks who pay the bills—and how hard can that be? The answer is not too hard if you don't care about:

- Timely payments and vendor relations
- Check fraud
- Duplicate payments
- State audits for unclaimed property
- State sales and use tax audits
- B Notices for incorrect 1099s
- Penalties for incorrect 1099 reporting
- Payment of independent contractors' taxes because of failure to obtain proper 1099 information
- Employee phony invoicing schemes
- Censure by the IRS for inappropriate reporting of non-resident alien income
- Inaccurate or incomplete accruals
- Inaccurate financial statements
- Failure of Sarbanes-Oxley review

These are just a few of the areas that a company can run into trouble with if proper policies and controls are not fully integrated into an organization's accounts payable function.

Establish the appropriate controls throughout the function even if it means that the comfortable routines of a few people will be disturbed. In the long run, it will benefit your organization.

## ELIMINATE REALLY BAD ACCOUNTS PAYABLE PRACTICES

More organizations than you would suspect employ what are generally considered really bad practices in some parts of their process. Many of these are inherited practices (we always did it that way), and others are a result of corporate culture (boys will be boys). Whatever the reason, Sarbanes-Oxley has shone its light on these dirty little secrets and at least some of the organizations that tolerated these practices are finally letting go of them. Before listing them, we have to salute the accounts payable professionals who seized the opportunity presented by Sarbanes-Oxley and used the Act as ammunition to get rid of the practices. Here are just a few of them:

- Petty cash box
- Dubious travel and entertainment (T&E) reimbursement practices
- Not enforcing the T&E policy equitably across the board
- Not using Positive Pay
- Not using a duplicate payment audit firm because the company "never" makes duplicate payments (since these firms almost always work on a contingency basis, why not verify that claim?)
- Allowing frequent rush checks to cover employee sloppiness
- Not mandating the use of a corporate T&E card
- Not requiring a W-9 before a payment is made to a vendor
- Ignoring the unclaimed property laws
- Not filing 1042 and 1042S for payments made to nonresident aliens

You can probably identify more in your own organization. Very few groups are immune from employing one or two bad

practices somewhere across their financial spectrum. Once you've identified them, try and root them out. If you need help, both your internal and external auditors are likely to be in your corner so get their support.

## PAPER TRAILS

Now more than ever it is crucial that a trail—be it paper or electronic—be established and easily verifiable. Timely documentation and a record retention policy that assures a clear audit trail are two good first steps toward complying with Sarbanes-Oxley as well as proof to state and federal auditors should your organization come under scrutiny by the authorities for not complying with one of their programs.

A verifiable audit trail ties into the concept of strong internal controls. Review your processes to ensure that the audit trail is there. Some companies find that they need to review their indexing procedures to get an acceptable audit trail.

## MONITORING REPORTS

Establishing effective controls, unfortunately, is not a one-shot project; it is an ongoing process. To ensure that the controls remain effective and function appropriately, they need to be reviewed on a periodic basis. Additionally, and equally important, reports need to be designed to ensure that the controls function as they should. They are also part of the control process. These reports can be best designed by figuring out where the potential weaknesses are in the process.

For example, one of the most common ways for an employee to commit check fraud is for the employee to simply change the mailing address of a vendor in the master vendor file. Then, once the check has been mailed, the employee with access to the master vendor file goes back into the system

and changes the address back to the correct address. It often takes months for it to come to light that the check went to the wrong vendor and an even longer time to track down where the check did go. If the employee is smart, he will have covered his tracks by that time.

How can you uncover this little scheme? A report of all changes to the master vendor file should be run each week (or month) and the report reviewed by someone at a fairly senior level not related to the process. By looking at all the changes, this little scheme would be uncovered. The problem with this approach is that few executives at senior levels want to wade through the minutia of the changes made to the master vendor file.

Review your own processes and find the applicable weak spots, and then design your own reports. Depending on your processes, you may need a few or many such reports. For example, if inactive vendors are infrequently (or, heaven forbid, never) deactivated in the master vendor file, you'll need to review any activity in formerly inactive accounts. A shrewd employee might use one of these accounts, along with some address changes to the master vendor file, to submit a phony invoice, get it approved, and then maneuver your organization's money into his or her bank account. By the way, if management is dragging its heels at deactivating inactive vendors, you might point out this scheme to them.

## AUTOMATED MONITORING FOR COMPLIANCE

There are two automated ways to monitor for S-Ox compliance. In some cases these processes were initially developed into the accounting systems to try and uncover fraud, duplicate payments, and other types of errors. Out of this grew independent S-Ox compliance applications. This has a clear benefit since these products are generally quite good. And just as obvious is the fact that the products that allow this con-

tinuous monitoring are expensive. As no one product has achieved market dominance, the various continuous monitoring applications include ACL Continuous Controls Monitoring Platform, Oversight Systems, Cashflow Guardian, APEX Analytical, Approva, Virsa, and Advantium.

On a less grand scale are data analysis products tailored for auditors or products based on Excel and Access. While these do not contain all the bells and whistles of their more expensive counterparts, they can be quite effective. Some can be purchased for as little as a few hundred dollars. Generally they are programmed to run every week or every month, or even before every check run. Two such packages are the $349 ActiveData for Office and the $149 ActiveData for Excel (*www.informationactive.com*). Both focus on fraud detection and cash recovery.

If you are interested in the automated approach but are not sure what software to purchase, consider *The 2005 Buyer's Guide for Audit, Anti-Fraud, and Assurance Software.* This very thorough book is the result of some exhaustive work by audit software industry expert Rich Lanza. (*www.auditsoftware.net*).

## TRAINING

In many organizations the accounts payable group gets the short shrift when it comes to continuing education. This is unfortunate and, to be perfectly honest, not really fair. On one hand, the organization relies on its accounts payable staff to:

- Keep up to date on each year's changes to the 1099 filing requirements.
- Know what's going on with regard to unclaimed property legislation.
- Be able to recommend and employ the best practices for the payables process, including all sorts of technological advances.

- Help prevent check fraud by implementing the latest controls available, as well as knowing about all regulatory changes.
- Establish routines that minimize duplicate payments.
- Integrate the sales and use tax calculations from as many as 10,000 taxing authorities into their daily routines.
- Spot phony invoices when they are submitted.
- Tactfully deal with belligerent and often uncooperative vendors.
- Skillfully handle angry employees who need T&E reimbursements despite the fact that their boss has still not approved their expense report.
- Implement controls and processes that will ensure that the company is in compliance with Sarbanes-Oxley in the payables unit.

For this, many organizations do not allocate anything for training the hardworking accounts payable professionals who staff their organizations. This is a crime. Currently, there are several organizations that provide training in all these areas. They offer on-site conferences where your professional staff can network with other professionals and learn from the best.

For organizations that do not wish to send their staff a distance, there are several groups that offer one-day local seminars.

If the staff can't leave the office, the Internet now brings the learning right into your office. And, of course, there are books and newsletters to help keep your staff up to date.

## CONCLUDING THOUGHTS

Conforming to the Sarbanes-Oxley Act is important not only for the public companies that are required to meet the guidelines, but also for those who just want to have strong internal controls to protect themselves against fraud and duplicate payments.

# PART V

# Appendices

# APPENDIX A

# Sarbanes-Oxley Act of 2002

The entire Sarbanes-Oxley Act of 2002 Report can be downloaded from *http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi? dbname=107_cong_reports&docid=f:hr610.107.pdf.*

**TITLE I—PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD**

Sec. 101. Establishment; administrative provisions.
Sec. 102. Registration with the Board.
Sec. 103. Auditing, quality control, and independence standards and rules.
Sec. 104. Inspections of registered public accounting firms.
Sec. 105. Investigations and disciplinary proceedings.
Sec. 106. Foreign public accounting firms.
Sec. 107. Commission oversight of the Board.
Sec. 109. Funding.

**TITLE II—AUDITOR INDEPENDENCE**

Sec. 201. Services outside the scope of practice of auditors.
Sec. 202. Preapproval requirements.
Sec. 203. Audit partner rotation.
Sec. 204. Auditor reports to audit committees.
Sec. 205. Conforming amendments.
Sec. 206. Conflicts of interest.
Sec. 207. Study of mandatory rotation of registered public accounting firms.
Sec. 208. Commission authority.
Sec. 209. Considerations by appropriate State regulatory authorities.

**TITLE III—CORPORATE RESPONSIBILITY**

Sec. 301. Public company audit committees.
Sec. 302. Corporate responsibility for financial reports.
Sec. 303. Improper influence on conduct of audits.
Sec. 304. Forfeiture of certain bonuses and profits.
Sec. 305. Officer and director bars and penalties.
Sec. 306. Insider trades during pension fund blackout periods.
Sec. 307. Rules of professional responsibility for attorneys.
Sec. 308. Fair funds for investors.

**TITLE IV—ENHANCED FINANCIAL DISCLOSURES**

Sec. 401. Disclosures in periodic reports.
Sec. 402. Enhanced conflict of interest provisions.
Sec. 403. Disclosures of transactions involving management and principal stockholders.

Sec. 404. Management assessment of internal controls.
Sec. 405. Exemption.
Sec. 406. Code of ethics for senior financial officers.
Sec. 407. Disclosure of audit committee financial expert.
Sec. 408. Enhanced review of periodic disclosures by issuers.
Sec. 409. Real time issuer disclosures.

**TITLE V—ANALYST CONFLICTS OF INTEREST**

Sec. 501. Treatment of securities analysts by registered securities associations and national securities exchanges.

**TITLE VI—COMMISSION RESOURCES AND AUTHORITY**

Sec. 601. Authorization of appropriations.
Sec. 602. Appearance and practice before the Commission.
Sec. 603. Federal court authority to impose penny stock bars.
Sec. 604. Qualifications of associated persons of brokers and dealers.

**TITLE VII—STUDIES AND REPORTS**

Sec. 701. GAO study and report regarding consolidation of public accounting firms.
Sec. 702. Commission study and report regarding credit rating agencies.
Sec. 703. Study and report on violators and violations.
Sec. 704. Study of enforcement actions.
Sec. 705. Study of investment banks.

**TITLE VIII—CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY**

Sec. 801. Short title.

Sec. 802. Criminal penalties for altering documents.

Sec. 803. Debts nondischargeable if incurred in violation of securities fraud laws.

Sec. 804. Statute of limitations for securities fraud.

Sec. 805. Review of Federal Sentencing Guidelines for obstruction of justice and extensive criminal fraud.

Sec. 806. Protection for employees of publicly traded companies who provide evidence of fraud.

Sec. 807. Criminal penalties for defrauding shareholders of publicly traded companies.

**TITLE IX—WHITE-COLLAR CRIME PENALTY ENHANCEMENTS**

Sec. 901. Short title.

Sec. 902. Attempts and conspiracies to commit criminal fraud offenses.

Sec. 903. Criminal penalties for mail and wire fraud.

Sec. 904. Criminal penalties for violations of the Employee Retirement Income Security Act of 1974.

Sec. 905. Amendment to sentencing guidelines relating to certain white-collar offenses.

Sec. 906. Corporate responsibility for financial reports.

**TITLE X—CORPORATE TAX RETURNS**

Sec. 1001. Sense of the Senate regarding the signing of corporate tax returns by chief executive officers.

## TITLE XI—CORPORATE FRAUD AND ACCOUNTABILITY

Sec. 1101. Short title.
Sec. 1102. Tampering with a record or otherwise impeding an official proceeding.
Sec. 1103. Temporary freeze authority for the Securities and Exchange Commission.
Sec. 1104. Amendment to the Federal Sentencing Guidelines.
Sec. 1105. Authority of the Commission to prohibit persons from serving as officers or directors.
Sec. 1106. Increased criminal penalties under Securities Exchange Act of 1934.
Sec. 1107. Retaliation against informants.

# APPENDIX B

## Segregation of Duties

The person responsible for bank reconciliation should not:

- Handle unclaimed property reporting
- Be a signer on a bank account

The person who is a check signer should not:

- Authorize an invoice for payment on an account on which he/she is also a signer
- Have ready access to the check stock

A person who is responsible for the check stock should not:

- Be an authorized signer
- Handle the bank reconciliations

The person who is responsible for the master vendor file should not:

- Be an authorized signer
- Be able to approve invoices for payment
- Handle unclaimed property

The person responsible for unclaimed property should not:

- Have responsibility for bank reconciliation
- Have access to the master vendor file

# APPENDIX C

## Blank Check Stock Security Features

Changes in the Uniform Commercial Code (UCC) could make organizations liable for fraud against checks if they don't take "ordinary care." American National Standards Institute (ANSI) standard X9.51 advises the use of at least three security features. Here are some security features that are currently on the market. New features are added regularly.

- American Banking Association (ABA) Check Endorsement Clause
- Anti-splice backer
- Copy void endorsement
- Copy void in check pantograph
- Covert fluorescent fibers
- Endorsement warning
- Fourdrinier (true) watermark
- Gradient two-color blend pantograph
- Image-friendly amount box
- Fluorescent fibers

- Control numbers
- Microprinting
- Multilanguage chemical void
- Non-negotiable stub backer
- Overt fibers
- Padlock security
- Simulated watermark
- Solvent-reactive color spotting
- Thermochromic ink
- Toner adhesion enhancement
- Voidless postal window
- Warning band
- Watermark certification seal

# APPENDIX D

## Demographics of the Purchase Card and Sarbanes-Oxley Survey*

The National Association of Purchasing Card Professionals (NAPCP), in conjunction with *Accounts Payable Now & Tomorrow* (AP N&T), surveyed 267 professionals with responsibility for their organization's purchasing card programs. The aim was to find out what these organizations were doing and how they were impacted by the Sarbanes-Oxley Act. Since professionals were encouraged to respond to the survey, not only with regard to the Act but also pertaining to their internal controls, a good number of organizations without specific Sarbanes-Oxley obligations responded. Thus, some of the demographics are broken down by whether or not there was a specified compliance requirement.

**Respondents by Category**

| | |
|---|---|
| Public | 58% |
| Private | 29% |
| Other | 13% |
| | 100% |

* Survey done by National Association of Purchasing Card Professionals in conjunction with *Accounts Payable Now & Tomorrow.*

**Respondents' Job Titles**

| | | |
|---|---|---|
| Program administrators, coordinators, managers | 108 | 40% |
| Accounting professionals | 42 | 16% |
| Procurement professionals | 46 | 17% |
| Controller/Finance/Treasury | 17 | 6% |
| Management (unidentified dept.) | 28 | 10% |
| Other, such as analysts and specialists | 26 | 10% |
| | 267 | 100% |

**SOX Requirement**

| | | |
|---|---|---|
| Yes, SOX is required | 144 | 54% |
| No, but choose to comply | 22 | 8% |
| No, but use different process | 36 | 13% |
| No, and do not have other process | 27 | 10% |
| Unsure | 38 | 14% |
| | 267 | 100% |

**Respondents Size by Organization Employee Count**

| | Total Respondents | | Required to Comply | |
|---|---|---|---|---|
| Less than 500 | 20 | 7% | 3 | 2% |
| 500 to 999 | 28 | 10% | 5 | 3% |
| 1000 to 4999 | 79 | 30% | 41 | 28% |
| 5000 and over | 138 | 52% | 93 | 65% |
| Unsure | 2 | 1% | **2** | **1%** |
| | 267 | 100% | 144 | 100% |

**Respondents by Organization Annual Sales**

| | Total Respondents | | Required to Comply | |
|---|---|---|---|---|
| Less than $100 million | 22 | 8% | 5 | 3% |
| $100 to $499 million | 25 | 9% | 14 | 10% |
| $500 to $999 million | 37 | 14% | 18 | 13% |
| Over $1 billion | 109 | 41% | 92 | 64% |
| Not applicable | 50 | 19% | 8 | 6% |
| Unsure | 24 | 9% | 7 | 5% |
| | 267 | 100% | 144 | 100% |

**Annual Purchase Card Dollar Volume**

| | Total Respondents | | Required to Comply | |
|---|---|---|---|---|
| Over $100,000,000 | 26 | 10% | 18 | 13% |
| $20,000,001–$100,000,000 | 69 | 26% | 47 | 33% |
| $10,000,001–$20,000,000 | 37 | 14% | 21 | 15% |
| $3,000,001–$10,000,000 | 63 | 24% | 28 | 19% |
| $1,200,000–$3,000,000 | 36 | 13% | 19 | 13% |
| Less than $1,200,000 | 30 | 11% | 10 | 7% |
| Don't know | 6 | 2% | 1 | 1% |
| | 267 | 100% | 144 | 100% |

**Annual Number of Purchase Card Transactions**

| | Total Respondents | | Required to Comply | |
|---|---|---|---|---|
| Over 500,000 | 18 | 7% | 15 | 10% |
| 100,001–500,000 | 57 | 21% | 41 | 28% |
| 50,001–100,000 | 47 | 18% | 25 | 17% |
| 15,001–50,000 | 64 | 24% | 29 | 20% |
| 6,000–15,000 | 25 | 9% | 10 | 7% |
| Less than 6,000 | 38 | 14% | 15 | 10% |
| Don't know | 18 | 7% | 9 | 6% |
| | 267 | 100% | 144 | 100% |

**Purchase Card Program Length (in Years)**

| | Total Respondents | | Required to Comply | |
|---|---|---|---|---|
| Less than one year | 21 | 8% | 8 | 6% |
| One to two years | 25 | 9% | 11 | 8% |
| More than two years, but less than five | 64 | 24% | 31 | 22% |
| Five years or more | 157 | 59% | 94 | 65% |
| | 267 | 100% | 144 | 100% |

**Number of Open Accounts**

| | Total Respondents | | Required to Comply | |
|---|---|---|---|---|
| Greater than 10,000 | 6 | 2% | 4 | 3% |
| 5,001–10,000 | 16 | 6% | 14 | 10% |
| 1,001–5,000 | 67 | 25% | 41 | 28% |
| 501–1,000 | 44 | 16% | 28 | 19% |
| 50–500 | 106 | 40% | 46 | 32% |
| Less than 50 | 22 | 8% | 9 | 6% |
| Don’t know | 6 | 2% | 2 | 1% |
| | 267 | 100% | 144 | 100% |

# APPENDIX E

## Independent Contractor or Employee 20 Questions

In *Revenue Ruling 87-41, 1987-1 CB 296,* the IRS developed 20 factors used to determine whether a worker is an independent contractor under the common law. As a general rule of thumb, at least 11 of these factors must show independent contractor status under the common-law tests. If you are in doubt, contact the IRS.

**For the following questions, a "yes" answer means the worker is an employee.**

1. Does the principal provide instructions to the worker about when, where, and how he or she is to perform the work?
2. Does the principal provide training to the worker?
3. Are the services provided by the worker integrated into the principal's business operations?
4. Must the services be rendered personally by the worker?
5. Does the principal hire, supervise, and pay assistants to the worker?

6. Is there a continuing relationship between the principal and the worker?

7. Does the principal set the work hours and schedule?

8. Does the worker devote substantially full time to the business of the principal?

9. Is the work performed on the principal's premises?

10. Is the worker required to perform the services in an order or sequence set by the principal?

11. Is the worker required to submit oral or written reports to the principal?

12. Is the worker paid by the hour, week, or month?

13. Does the principal have the right to discharge the worker at will?

14. Can the worker terminate his or her relationship with the principal any time he or she wishes without incurring liability to the principal?

15. Does the principal pay the business or traveling expenses of the worker?

**For the following questions, a "yes" answer means the worker is an independent contractor.**

1. Does the worker furnish significant tools, materials, and equipment?

2. Does the worker have a significant investment in facilities?

3. Can the worker realize a profit or loss as a result of his or her services?

4. Does the worker provide services for more than one firm at a time?

5. Does the worker make his or her services available to the general public?

# About *Accounts Payable Now & Tomorrow*

*Accounts Payable Now & Tomorrow* is a new monthly publication devoted to payment issues. Each issue will contain:

- Four to six hard-hitting articles offering practical advice to the many problematic issues confronting payables operations everywhere
- Two guest columns from the most-respected names in their fields covering specialty functions including: 1099s, sales and use tax, unclaimed property, p-cards, VAT, banking issues (positive pay, ACH, Check 21, etc.), accounting issues (yes, Sarbanes-Oxley, internal controls etc.), fraud, software and audits, and more.
- A Tips, Tactics, and Strategies section . . . and much more.

With your paid subscription, you'll also get a weekly e-zine, *e-News from the AP Front*, a quick-read e-mail update, the opportunity to participate in and get the results from groundbreaking research focused on payment issues.

To receive a sample copy of the print publication, send an e-mail to publisher@ap-now.com with the words "Wiley sent me" in the subject line. Make sure you include your company name, title, and mailing address.

If you would prefer to just be added to the distribution of the complimentary e-zine, simply send the same information with a note to that effect to publisher@ap-now.com

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