




SOX & Procurement What's The Connection?

Mike Taylor, C.P.M.
April 2006

Fair warning.....
I am not a lawyer,
nor an auditor
- amen!


1



Agenda

- What is SOX?
- Why does it impact Supply Chain organizations?
- What can we do to get ready for SOX?
- How do we survive a SOX audit?

ML Taylor 2



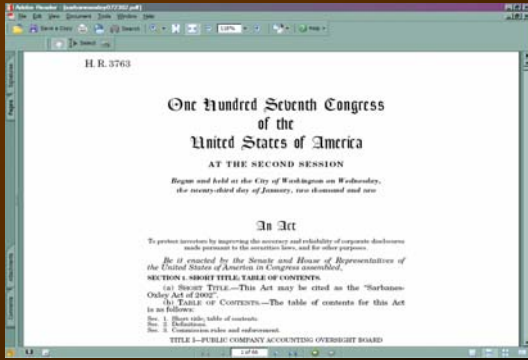
What Is SOX?

- Sarbanes Oxley Act of 2002
- Directs SEC to enact rules protecting shareholders & the economy
- Honesty in financial reporting
- Responsibility at the Top
- Demonstrate Compliance by Audits

Audit Audit Audit Audit Audit Audit Audit Audit Audit Audit Audit

ML Taylor 3

The SOX Act



The SOX Act



What Does SOX Say?

- Section 404 of the SOX Act, Management Assessment of Internal Controls; "... adequate internal control structure.....".
- That is; *does your company have internal controls to prevent financial loss and fraud? This includes the financial liabilities associated with procurement and subcontracting.*

ML Taylor

5



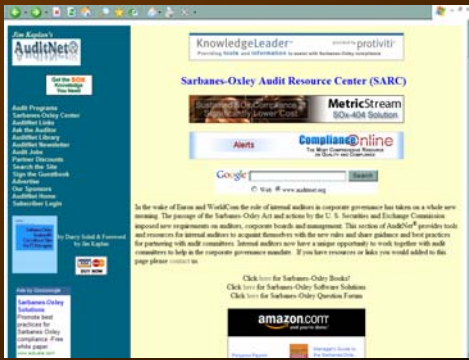
Perspective - mlt

- "There will be management accountability in financial reporting of public companies – or else " mlt

ML Taylor

6

AuditNet SOX Center



www.auditnet.org



SOX Buzzword: Control Points

- A method of limiting the risk in a process
- A "touch point" for procedures, or systems that assists management in controlling risks
- Control points are
 - Systematic – they happen automatically or as a normal practice
 - Reproducible –
 - Verifiable
- Prevent fraud, waste and abuse (at least theoretically)

ML Taylor

8



Why Is Supply Chain A Target?

- Procurement spends a large % of budget
- Potential for spending abuse
- Opportunity for kickbacks & bribes
- Conflict of interest concerns
- Legal risk of contracting & lawsuits
- Long-term product liability & defective parts

ML Taylor

9



Typical Process

- Requirement definition
- Contractor evaluation & source selection
- Price & payment schedule
- Receipt & inventory control
- Payee information & issuing checks
- Accountability for cash flow
- Closeout of legal liability

ML Taylor

10



Supply Chain Processes Typical Risks

- The wrong product - *shuts down production*
- The wrong source – *doesn't deliver*
- Poor contract – *invites lawsuits*
- Lack of receipt controls – *invites fraud*
- Invoices not reviewed – *payment errors*
- ★ Supply chain risk assessment resource:
Quality Plus Engineering, Greg Hutchins

ML Taylor

11

Procurement Fraud Counsel



Google search: +Procurement +Fraud



Prepare for an Audit

- Document process which acquires the right product at the right price for the right reasons with the least overall cost and risk?
- Mitigate supply chain risks
- Fraud awareness training
- Ethics training
- Establish adequate control points
- Maintain records to prove it

ML Taylor

13



Concerns? A few examples:

- *Ever been asked to change the effective date on a contract or invoice because of the way it impacts the company month end?*
- *Ever stretch payments beyond the contract terms to mitigate cash flow problems?*
- *Ever loose valuable inventory or tools?*
- *Ever select a vendor who is not the lowest priced responsive responsible offeror?*
- *Ever issue payments that don't match contract terms?*
- *Always vet contractor personnel before allowing access to plant and offices?*
- *Always insist on signed non-disclosure agreements before sending contractors proprietary specifications & drawings?*

ML Taylor

14



Discussion:

- What are typical functions in need of control?
- What are the risks & what can we do about them?
- Are control points the same in each company?
- What controls could be written in to new contracts to mitigate risks?
- What functions should be separated?

ML Taylor

15

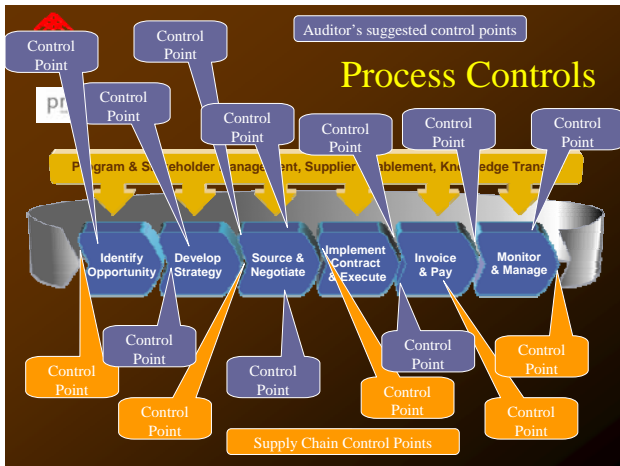


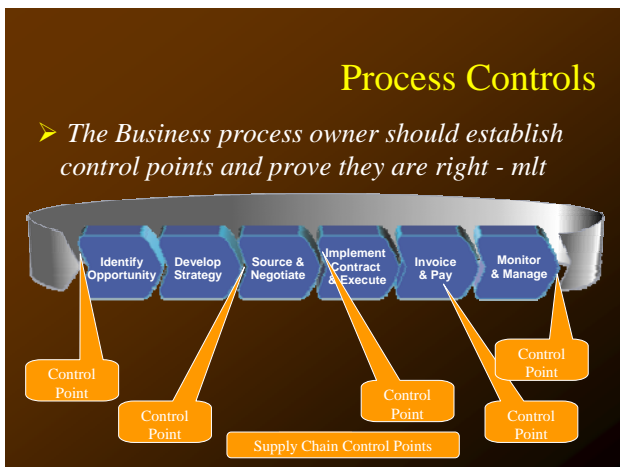
Control Points; *Examples*

- Separate & rotating authority; multiple approvals
- Functional stove-pipes; 3-way accounting match
- System & Software controls
- Bank cards limited to certain commodities
- Contracts address risk; maximum order value
- Automatic review triggers
- Management oversight with reports and audits

ML Taylor

16





➤ *The Business process owner should establish control points and prove they are right - mlt*



Self Assessment

Why would auditors want to talk to me?

- What percentage of budget do I control?
- What apparent authority do I have?
- What oversight do I get vs. what I expect?
- Does senior management know what procurement fraud would look like?
- What record information do I create?
- What would supply chain fraud look like?

ML Taylor

19



Personal Actions

- Be deliberate; act with due diligence
- Think about consequences & appearances
- Consider how an auditor could misinterpret actions
- Avoid appearance of conflict of interest
- Notify management when processes are broken or poor supply chain decisions impact the company
- Document management direction
- Don't be ambiguous by doing one thing and saying another

ML Taylor

20

Association of Certified Fraud Examiners



www.acfe.com



Company Officials

- Have an obligation to prevent fraud
- Responsibility to make it happen
- Using adequate internal controls
- Which are regularly tested
- Identifying weaknesses
- Mitigating risks
- Verifying improvement & compliance

AICPA

American Institute of Certified Public Accountants



www.aicpa.org/antifraud/homepage.htm



Management Suggestions

- Hire, train & support a professional staff
- Use written & regularly reviewed policies
- Provide training & time to administer contracts
- Enforce a reasonable ethical policy
- Avoid noncompetitive supplier agreements



Management Suggestions

- Ensure internal controls
- Separate functions;
 - requesting, buying, receiving and paying
- Checks and balances & regular reviews
- Consider all risks of poor supply chain management ...
 - ...Not just the negative impact on production
- Listen to feedback & concerns

ML Taylor

25



Questions?

- Does SOX affect Federal Agencies?

ML Taylor

26



SOX & Federal Agencies?

- Short answer is NO. Right answer is YES!
- GAO - Comptroller General remarks regarding agency management accountability
- OMB Circular A-123 –
 - Financial Controls for Federal Agencies
 - Revision effective October 2005

ML Taylor

27

Qui Tam Claim -



Invites public to help detect fraud



Questions?

- Does SOX affect Federal Agencies?
- Can purchasing card programs survive Sox?

ML Taylor

32



Purchasing Card We can mitigate the risks by:

- Limiting exposure with card and bank controls
- Contract controls for products & contractors
- Using robust peard software
- Auditing & reviewing transactions
- Maintaining management control
- Rotating assignments
- Training users & training managers
- Keeping good records

ML Taylor

33



Questions?

- Does SOX affect Federal Agencies?
- Can purchasing card programs survive Sox?
- What can I do to prepare for a SOX audit?

ML Taylor

34



Prepare For An Audit

- Become sox-aware
- Understand the critical process risks
 - Potential for fiscal mismanagement
 - Potential for fraud/criminal activity
- Document the rationale for control points
- Keep independent confirmation that the control point is working

ML Taylor

35



Survive An Audit:

- Have command of the facts
- Prepare to answer the 'hot' issues
- Don't confuse facts with opinion
- Document control-related directions, approvals and decisions
- Maintain personal records
- Step back and get perspective

ML Taylor

36



Supply Chain SOX Mantra

- Did we pay the right vendor
- The right amount
- For a product or service we received
- Which met our company's requirements
- And was the most cost effective
- Without any outstanding liability
- Or residual risk

ML Taylor

37



Cool Links

- DOJ antitrust primer for law enforcement personnel
www.usdoj.gov/atr/public/guidelines/209114.htm
- DOJ field guide on new criminal authorities in SOX
www.usdoj.gov/ag/readingroom/sarox1.htm
- Quality Plus Engineering > enterprise risk management – Greg Hutchins
www.qualityplusengineering.com/

ML Taylor

38



Follow-up

- Google Search:
 - +SOX +Procurement
 - "Procurement Fraud"
- BuyTrain news archive
 - www.mltweb.com/tools/buytrain/index.htm
- Purchasing Toolbox articles
 - www.mltweb.com/prof/tools.htm
- Workshop Handout & Review notes
 - www.mltweb.com/seminars/index.htm

ML Taylor

39



Questions?

- Does SOX affect Federal Agencies?
- Can purchasing card programs survive Sox?
- What can I do to prepare for a SOX audit?
- More ??????????????

ML Taylor

40



Extra Credit Discussion

- Is it illegal for a buyer to accept gratuities?
- When does a gratuity become a kickback?
- Who cares if we buy the most expensive product instead of the most cost effective?
- Can a supply chain manager be considered a "company official" when indictments are handed down?

ML Taylor

41



Notes

ML Taylor

42
