MIS 5121: Business Processes, ERP Systems & Controls

Week 3: *Fraud, Procure to Pay Process Controls*
Video: Record the Class
Discussion

- Something really new, different you learned in this course in last week

- Questions you have about this week’s content (readings, videos, links, ...)?

- Question still in your mind, something not adequately answered in prior readings or classes?
Risk

Definition

‘Probability or threat of damage, injury, liability, loss, or any other negative occurrence that is caused by external or internal vulnerabilities, and that may be avoided through preemptive actions (controls?)’

Business Dictionary

‘Anything that could go wrong’

Class Definition
Fraud

Definition

‘deception (misrepresentation or omission) deliberately practiced in order to secure unfair or unlawful gain’
Environment Favorable to Fraud
Framework for spotting high-risk situations

- **Perceived opportunity** (*I can do it / conceal it and not get caught*)
  - Poor internal controls
  - Lack of oversight

- **Incentive or Pressure** (*Financial or emotional force pushing to commit fraud*)
  - Meet expectations
  - Avoid criticism
  - Cover a mistake
  - Personal failures, needs

- **Rationalization** (*Personal justification for dishonest actions*)
  - Low compensation
  - Company is profitable

Fraud Triangle
Business Process Controls

Procure to Pay
Procurement Process

1. Determination of reqmts
2. Source determination
3. Vendor selection
4. PO processing
5. PO monitoring
6. Invoice verification
7. Goods receipt
8. Payment processing
Procurement at GBI

- **Marketing / Sales**
  - Customer Service
- **Supply Chain**
  - Goods Receipt
  - Reqmts
  - Purchase Order
  - Vendor / Sourcing
- **Conversion**
- **Procurement**
- **Warehouse Distribution**
- **Finance / HR**
  - Billing
  - Accounts Receivable
  - Invoice Verify
  - Accounts Payable
  - Procurement
  - Conversion
The Many Flavors of Procurement

What Does Global Bike, Inc. Procure?

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The Many Flavors of Procurement

- Materials / Raw Materials
- Labor Services
- Other Services
- Leases / Rentals
- Supplies (Office, Maintenance, Production, …)
- Logistics
- Information Technology
- No PO
- Inter-company vs. 3rd Party
- Acquisitions
Procure to Pay: Common Risks

Vendor / Purchase Order
• Creation of fictitious vendors, purchase orders and service/good receipt
• Purchases not correctly Authorized
• Delivery address modification
• Inadequate price negotiation
• Price increase in purchase orders (to establish a kickback program)
• Records lost / destroyed

Goods / Service Receipt
• Import / export control violations
• Quality of goods / services received
• Inventory manipulation
• Records lost / destroyed
• Over / under charged workload / hours / costs
Procure to Pay: Common Risks

Invoice Processing / Payment
• Modification of vendors payment information
• Manipulation of client names and addresses on vouchers / refund
• Price increase in purchase orders (to establish a kickback program)
• Over / under charged workload / hours / costs
• Wrong payments / duplicate payments
• Approval of fictitious travel expenses
• Records lost / destroyed
Controls: 3-way Match

Example of Configurable Control
Controls: GR/IR Reconciliation Account

**GR / IR:**

**Goods Receipt / Invoice Receipt**
- Standard accounting method for P2P
- ‘In/Process’ type of account
- For given transaction (PO) once complete the account value should be zero
- Easy focus on incomplete, erroneous transactions

![Diagram of GR/IR Reconciliation Account](diagram.png)
Procure to Pay: Common Controls

- Segregation of Duties
- Purchasing policies (Written, taught, monitored)
- Contract / PO approvals
- PO revisions monitored / controlled
- Vendor / source / price Decisions Monitored
- Supplier / Procurement independence
- Avoid Advance payments
- Invoices sent to A/P
- Monitor GR / IR Account
- Return Procedures (written, taught, monitored)
- ‘No PO’ payments avoided / controlled
- 3-way Match used where possible
Reference

• Checklist: Standards of Internal Control for Purchasing and Ordering (Institute of Finance & Management)

• Checklist: Standards of Internal Control for Supplier Selection (Institute of Finance & Management)
Purchase-to-Pay Exercise

• Primary Learning objectives
  – Experience the steps in a typical purchasing transaction
  – See how an ERP system handles typical purchasing transactions
  – Work through the procedures involved in a test of transactions
  – Investigate related application controls in an ERP system

• Secondary learning objectives:
  – See the integration between materials management (MM) and financial accounting (FI) modules of SAP
  – View some basic FI module settings than enable proper system functions
Exercise 1: Purchase to Pay

• Agenda
  – Last Class (September 12): Logging On; Steps 1 - 6
  – This Class (September 19): Steps 7 - 14
  – Due Thursday September 22 11:59 PM: Assignment Submission
Exercise 1: Purchase to Pay

• Task 7 — Create a Purchase Order to Buy the Trading Good
  – Menu: **Logistics ▶ Materials Management ▶ Purchasing ▶ Purchase Order ▶ Create ▶ Vendor/Supplying Plant Known**
  – Transaction: **ME21N**

• Task 8 - Check Status of Various Accounts
  – Check Inventory: MM Inventory Quantity
    Transaction: **MMBE (Stock Overview)**
  – Check GL Inventory, GL Cash, GL A/P, GR/IR (Goods Received / Invoice Received):
    Transaction: **S_ALR_87012291 (Line Item Journal)**
    Recommend: Use **/MIS5121** Layout Variant
  – Check A/P Vendor sub-ledger:
    Transaction: **FBL1N (Vendor line item display)**
Exercise 1: Purchase to Pay

- Task 9 – Receive the Product from the Vendor
  - Menu: Logistics ➤ Materials Management ➤ Inventory Management ➤ Goods Movement ➤ Goods Receipt ➤ For Purchase Order ➤ PO Number Known
  - Transaction: MIGO

- Task 10 - Check Status of Various Accounts
  - See details of Task 8

- Task 11 – Receive the Invoice from the Vendor
  - Menu: Logistics ➤ Materials Management ➤ Purchasing ➤ Purchase Order ➤ Follow-on Functions ➤ Logistics Invoice Verification
  - Transaction: MIRO
Exercise 1: Purchase to Pay

• Task 12 - Check Status of Various Accounts
  – See details of Task 8

• Task 13 – Make the Payment to the Vendor
  – Menu: Accounting ► Financial Accounting ► Accounts Payable ► Document Entry ► Outgoing Payment ► Post
  – Transaction: F-53

• Task 14 - Check Status of Various Accounts
  – See details of Task 8

• Task 15 – Write down the system-generated journal entries
  – Non-SAP task
Extra Slides
Most Common Fraud Techniques

- Understatement of expenses/liabilities (31%)
- Other techniques such as acquisitions, JVs, netting of amounts (20%)
- Disguised through use of related parties (18%)
- Misappropriated assets (14%)

# Asset Misappropriation Fraud Schemes

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
<th>Examples</th>
<th>% cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Billing</td>
<td>Causes employer to issue payment by submitting invoices for fictitious goods or services, inflated invoices or invoices for personal purchases</td>
<td>Employee creates a shell company and bills employer for services not actually rendered</td>
<td>26.0 %</td>
</tr>
<tr>
<td>Non-Cash</td>
<td>Employee steals or misuses non-cash assets of the organization</td>
<td>Employee steals or misuses non-cash assets of the Organization steals or misuses confidential customer financial information</td>
<td>16.3 %</td>
</tr>
<tr>
<td>Revenue Reimburse</td>
<td>Employee makes a claim for reimbursement of fictitious or inflated business expenses</td>
<td>Employee files fraudulent expense report, claiming personal travel, etc.</td>
<td>15.1 %</td>
</tr>
<tr>
<td>Skimming</td>
<td>Cash is stolen from an organization <strong>before</strong> it is recorded on the organization's books and records</td>
<td>Employee accepts payment a customer, but does not record the sale, and instead pockets the money</td>
<td>14.5 %</td>
</tr>
<tr>
<td>Check tampering</td>
<td>Person steals his employer's funds by intercepting, forging, or altering a check drawn on one of the organization's bank accounts</td>
<td>Employee steals blank company checks and makes them out to himself or an accomplice</td>
<td>13.4 %</td>
</tr>
<tr>
<td>Cash on Hand</td>
<td>Perpetrator misappropriates cash kept on hand at the victim organization's premises</td>
<td>Employee steals cash from a company vault</td>
<td>12.6 %</td>
</tr>
<tr>
<td>Cash Larceny</td>
<td>Cash is stolen from an organization <strong>after</strong> it is recorded on the organization's books / records.</td>
<td>Employee steals cash and checks from daily receipts before they can be deposited in the bank</td>
<td>9.8 %</td>
</tr>
<tr>
<td>Payroll</td>
<td>Employee causes his employer to issue a payment by making false claims for compensation</td>
<td>Employee claims overtime for hours not worked or adds ghost employees to the payroll</td>
<td>8.5 %</td>
</tr>
<tr>
<td>Cash Register</td>
<td>Person makes false entries on a cash register to conceal fraudulent removal of cash</td>
<td>Employee voids a sale on the cash register and steals the cash</td>
<td>3.0 %</td>
</tr>
</tbody>
</table>

Source: Association of Certified Fraud Examiners – 2010 Report to the Nations on Occupational Fraud and Abuse – Global Fraud Study
I just finished that course on fraud.

How was it?

Great! They showed us all sorts of ways to make money.
Exercise 1: Purchase to Pay

• Task 6 - Check Status of Various Accounts
  – Check Inventory: MM Inventory Quantity
    Transaction: **MMBE (Stock Overview)**

  – Check GL Inventory, GL Cash, GL A/P, GR/IR (Goods Received / Invoice Received):
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