

# Accounts Payable Audit Procedures



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An accounts payable audit is an independent review of all accounts payable procedures and records. An accounts payable audit is a necessity for all businesses, regardless of size.

For larger businesses, an accounts payable audit isn't an option - it's a requirement. With the introduction of the Sarbanes-Oxley Act in 2002, if you're a publicly held company, you are required by law to submit all appropriate records for an independent audit.

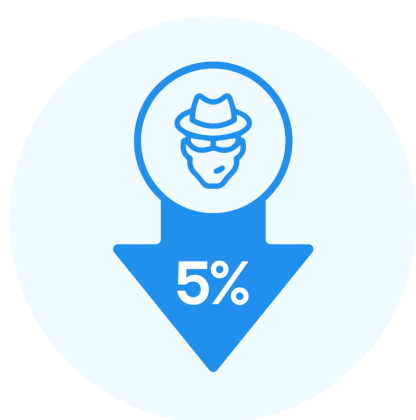
But small businesses aren't off the hook. Even if your business is privately owned, an independent audit is a good risk assessment tool that can help you uncover

potential fraud or identify other weak spots in your accounting procedures.

In a 2020 study, the Association of Certified Fraud Examiners found that the average organization loses around 5% of revenue to fraud. Whatever size business you work for, losing 1/20th of your profits to fraud has a huge impact.

The same study identified that lack of internal controls contributed to nearly 1/3 of all fraud. Conducting an audit regularly, even an internal audit, can keep your business financially healthy for the long term.

## ■ Business Revenue Lost to Fraud



The average business loses around **5%** of annual revenue to fraud

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## What Is an Accounts Payable Audit?

An accounts payable audit is a process designed to examine all of the financial records that flow through the accounts payable department.

An accounts payable audit should always be performed by an independent accounting firm to maintain objectivity throughout the process. When auditing accounts payable, auditors are generally looking for the following.

### • Accuracy of the Transaction

Auditors will examine a variety of transactions, in some cases performing recalculations to determine the accuracy of the original transaction. For example, they may look at a purchase order, invoice, shipping and receiving documentation, and payment to determine that all were

recorded and paid properly.

## ▪ **Completeness of Transactions**

Auditors will look to see that transactions are complete. For example, if you have accounts payable entries reflecting a payment to a supplier, they will look for a valid audit trail to support that entry, including relevant supporting documents as well as payment method.

They will also examine open accounts payable invoices to ensure there is a corresponding invoice.

## ▪ **Compliance**

If you're a publicly owned business, auditors will examine the internal processes of your AP department to ensure that it adheres to Generally Accepted Accounting Principles (GAAP) requirements. It is important to follow GAAP in accounts payable and finance more generally.

## ▪ **Validity**

Auditors will take a close look at the validity of accounts payable transactions. This process usually involves contacting third-party suppliers and vendors to confirm specific transactions.

Looking at these areas helps the auditor to determine whether the accounts payable records audited are an accurate representation of the business. The results of an audit help to determine if the proper accounts payable internal controls are in place.

## Hallmarks of Effective Accounts Payable Audit Procedures



Ensure Accuracy of Transactions



Examine of Transactions for Completeness



Review Compliance with GAAP



Verify the Accuracy and Validity of Transactions

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## How Do You Audit Accounts Payable?

Auditors are tasked with examining accounts payable-related records for authenticity while also looking for signs of fraud along with general mistakes.

Rather than worry, provided that they are doing things properly, accounts payable departments should look at audits as an opportunity to uncover and correct any potential issues before they become serious.

Are you wondering exactly what auditors may want to look at during an AP audit? While it can vary, auditors will likely want to look at the following:

- A thorough review of accounts payable internal controls
- A detailed, period-ending accounts payable ledger
- Documentation for any unrecorded liabilities
- The process for handling expenses
- Is three-way matching used in accounts payable?
- How purchase orders are handled
- Is there clear segregation of duties used in accounts payable?
- How credit card purchases are handled
- Who reviews vendor activity?
- The process for handling new vendors
- The accounts payable approval process
- Does the company use electronic payments?
- If electronic payments are used, what method is employed?
- Relevant financial reporting including a balance sheet and cash flow

statements

Once an audit has been scheduled, there are four separate analytical procedures involved in the accounts payable audit process.

## 1. **Audit Planning**

Before the audit begins, the firm conducting the audit will contact the business, establishing goals and parameters.

Once this is done, the auditing firm will complete an audit plan that will be shared with the business during an initial meeting where goals and audit objectives will be discussed.

An initial checklist of items that will be looked at is usually shared with the business undergoing the audit at this time.

## 2. **Examining the Records**

Considered the fieldwork phase, the most intense part of the audit is the examination of accounts payable records. The examination phase can last for several weeks, with numerous records examined during the audit, and can include any or all of the following:

- **Review of Original Documentation**

This includes vendor invoices, purchase orders, inventory documentation, and any related accounts payable journal entries. Bank records to examine payments, whether by check or ACH will also be reviewed.

This is done to ensure that payment has been made correctly to the appropriate vendor for the amount indicated.

- **Research Vendor Activity**

Look for any unusual activity that may need to be investigated further. Using the cutoff test, auditors will also look at any outstanding vendor balances and compare totals to those in the

general ledger.

- **Review Current and Historic Budgets**

Check and note any discrepancies that need to be investigated further.

- **Review and Verify the Accuracy of Financial Statements**

The review should include the current payables balance. Auditors will also look at current accounts payable policies and procedures that are in place.

Closing processes will be examined (monthly, quarterly, or annual) to ensure that expenses are recorded in the period in which the expense was incurred.

Special attention will likely be paid to larger accounts payable transactions, with specific vendors chosen at random for more in-depth investigation.

- **Fraud Detection**

Auditors will search for any unrecorded or improperly recorded liabilities and will take measures to look for suspicious activity that may indicate potential fraud.

### 3. **Reporting**

When the audit has been completed, the complete findings are analyzed and put into a report.

The audit report, prepared by the auditing firm, provides an overview of the areas examined and the processes involved, including the financial accuracy of accounts payable, and how well it confirms to GAAP standards.

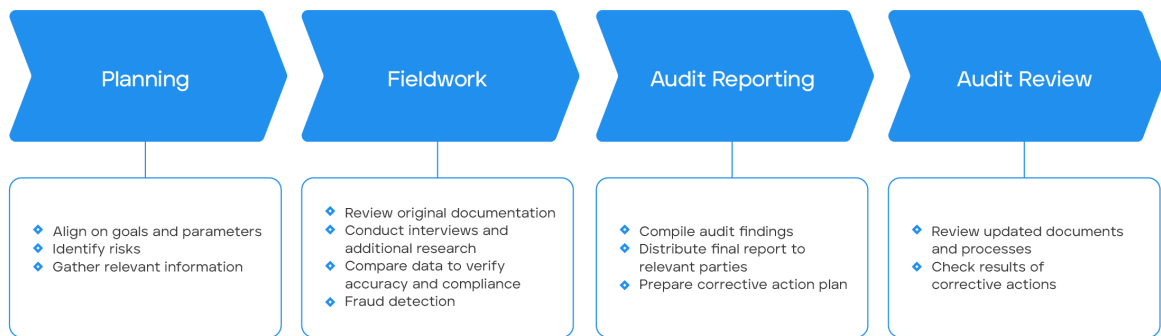
The report also includes feedback from the auditor on any areas of

concern and provides general guidelines for moving forward. The report is submitted to both management as well as other stakeholders if necessary.

## 4. Audit Review

The audit and initial reporting is the final stage of the audit. However, depending on the auditor's initial report, there is usually a follow-up audit scheduled to determine whether questions have been answered and concerns addressed properly.

### Conducting a Successful Accounts Payable Audit



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*Auditing accounts payable is particularly important because understatement of liabilities and theft are two main occurrences that directly impact accounts payable.*

## What Are the Typical Audit Procedures?

When auditing accounts payable, most auditors will use five or possibly seven audit procedures. The five most common audit procedures include the following.

### 1. Observation

Observation is when auditors spend time observing typical business processes. This can include anything from entering a new vendor into the

accounting software to whether inventory is counted properly. Depending on the type of business that is being audited, keen observation can point out operational deficiencies.

## 2. **Inquiry**

The inquiry portion of an audit stems from the auditor reviewing reports, financial statements, transactions, and balances. During this review process, any unusual or suspicious transactions will be inquired about, with the business required to supply the appropriate explanation or supporting documentation.

## 3. **Analytical Review**

Analytical review includes a review of account balances, trends, and market information to help ensure that financial statements reflect accurate balances. Analytical review can include sales comparisons to the previous year, expense analysis, and comparing marketing expenses with revenue.

## 4. **Inspection**

The inspection of records and transactions is the heart of the audit process. The inspection process typically involves an onsite review of both internal and external documents including sales invoices, payment details, and purchase orders to ensure that both accounts payable expenses and payments are recorded properly and that open balances match those in the general ledger.

## 5. **Recalculation**

The recalculation process is used when auditors perform a calculation to check their accuracy. The auditor then compares the calculation result with the number currently recorded in the general ledger. Recalculations are often done for areas such as depreciation and deferred expenses.

While these are the five audit processes, some auditors will add the



following processes when conducting an audit.

## 6. Reperformance

Similar to the recalculation process, this process is used to reperform key internal controls to check for any deficiencies. These internal controls include the establishment of responsibility, segregation of duties, physical control, documentation process, internal verification, and human resource control.

## 7. Confirmation

Confirmations are performed when auditors need to verify transactions with third-party businesses such as vendors, banks, and other financial institutions.

### 7 Typical Audit Procedures



Observation



Inquiry



Analytical Review



Inspection



Recalculation



Reperformance



Confirmation

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# How Do You Test the Completeness of

# Accounts Payable?

During the audit, the auditor should test for the completeness of accounts payable. The primary method for testing the completeness of accounts payable is to search for unrecorded liabilities.

This is done by obtaining a list of all cash disbursements made after year-end. Once these payments have been identified, the auditor requests a copy of the invoice to determine whether it was properly recorded at year-end.

The payables listing total should always agree with the balance recorded in the general ledger. When performing the completeness test, auditors will also randomly select vendor statements to see if they match with the vendor account. The timeliness of the recording of the payables will also be examined.

Auditors also look at the approvals process and whether the payable was recorded properly, in the correct accounting period, for the correct amount.

## How To Test the Completeness of Accounts Payable



Reconcile Accounts Payable Ledger and Control Account



Match Cash Disbursements to Reduction in Accounts Payable



Match Payments to Suppliers To Relevant Account



Assess Transactions Made After Year End For Unrecorded Liabilities



Compare Supplier Statements to Accounting Records

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## Why Is Auditing Accounts Payable Regularly Important?

Auditing is an important process for any business, but auditing accounts payable is particularly important since understatement of liabilities and theft are two main occurrences that directly impact accounts payable. There are three areas in

particular that accounts payable is vulnerable to.

### **1. Intentional Understatement of Accounts Payable**

This is often done by management to show a higher level of profit.

### **2. Payments Made to Fake Vendors**

Without the proper safeguards in place, it's easy for unscrupulous employees to create fake vendors and issue payments to that vendor.

### **3. Duplicate Payments Are Made to Vendors**

Sometimes a duplicate payment happens purely by mistake. But in some cases, the duplication is on purpose.

Having the proper controls in place can reduce or even eliminate these occurrences. Controls include ensuring segregation of duties in the accounts payable process.

For example, one person would approve purchases while another would be responsible for vetting and entering vendors into the accounts payable system. Called segregation of duties, it's important for all businesses, even small ones to have controls in place.

## **How To Prepare for an Audit**

If your business is scheduled for an audit, there are a few things you can do to prepare. While preparation may not be necessary, it can make the process go a lot smoother.

- Have any requested documents including checks, bank statements, financial statements, invoices, and purchase orders ready for the auditor when they arrive.
- Make sure that all of your bank accounts have been reconciled before the audit begins.

- Be prepared to spend a significant amount of time with the auditor, answering questions, explaining procedures, and pulling additional documentation.

## **Audits Don't Have To Be Scary**

Audits are a necessary part of doing business, but they don't have to be scary. If you have the proper tools and resources in place to automate the entire AP process from initial purchase order to invoicing, to payment processing, your accounts payable processes will be transparent.

With a good AP automation software and procure-to-pay software application, you can process your invoices faster, so your suppliers get paid faster while reducing errors and eliminating the possibility of fraud. Better yet, you'll increase your chances of passing your next accounts payable audit.

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