

Internal Audit

BANK NAME

DATE

**Accounts Payable Testing
Includes Income, Expense, and Accrued Items**

Findings Report

Introduction:

A general understanding of a bank's balance sheet, income and expense accounts, and vendor payment process is necessary to analyze a bank's earnings performance effectively. Therefore, portions of the Report of Condition, Income Statement, and accounts payable system are reviewed in conjunction with this area. In reviewing these areas, the following definitions apply:

- Income is generated by an excess of revenue over expenses for an accounting period and it is the amount by which total assets increase in an accounting period.
- Expense is the cost incurred in the bank's efforts to generate revenue, representing cost of doing business. Expenses may be in the form of actual cash payments (such as wages and salaries), a computed 'expired' portion (depreciation) of an asset, or an amount taken out of the firm's earnings (such as bad debts). Expenses are summarized and charged in the bank's income statement as deductions from the income before assessing income tax.
- Accrued Income is the amount earned in the current accounting period, but which will be received in a subsequent period.
- Accrued Expense is the short-term liabilities (such as interest, taxes, utility charges, wages) which continually occur during an accounting period but are not supported by an invoice or a written demand for payment. When preparing financial statements for that accounting period, such liabilities are estimated on the basis of experience (based on previous payments). Similar increases in the assets of the bank (which may also continually occur) is not taken into account in order to comply with accrual basis accounting rules.
- Accounts Payable is money which the bank owes to vendors for products and services purchased on credit. This item appears on the bank's balance sheet as a current liability, since the expectation is that the liability will be fulfilled in less than a year.

Risks associated with these services include:

- Transaction Risk
- Reputation Risk
- Liquidity Risk
- Strategic Risk

Objectives:

- To review internal control questionnaire and determine that employees are operating in compliance with Bank policies and procedures.
- To review Managements reconciliations of the General Ledger Accrued Interest totals along with Bank reports and trial balances.
- To analyze income and expense accounts and review for unusual fluctuations; to review support documentation for explanation of fluctuations.
- To determine if purchases are made in accordance with procedures; to review a sample of purchase orders.
- To determine if disbursements of expenses are made in accordance with procedures.

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- To review the appropriateness of the expense account usage by executives and senior management.

Audit Procedures:

- Complete Internal Control Questionnaire (ICQ). Specifically review system access for establishing vendors, payment of invoices, and payment prevention of duplicate invoices.
- Complete/update Accounts Payable Documentation of Controls Walkthrough.
- Review the Board approved Accounts Payable Policy and applicable internal procedures to ensure processes are current.
- Prepare a summary of reconciliations of the General Ledger Accrued Interest account totals to applicable Bank reports, i.e., Income and Expense Report, various Demand Deposit and Loan reports, and accrual reports as of DATE using Management's prepared reconciliations of individual accounts for review.
- Review the Income and Expense Report, Income Statement, and Management's explanations of Budget vs. Actual Report as of DATE for any significant fluctuations.
- Haphazardly select a sample of invoices paid in YEAR. Review for proper approval, corresponding payment, accrual or expense posting and A/P Register. In addition, review purchase orders where applicable. For large disbursements, compare invoice(s) to budget and contract or sales agreement.
- Review the disbursement process within the Accounting Department to determine that proper controls are in place and segregation of duties are followed for payment of purchases and expenses.
- Select a sample of senior/executive personal expense reimbursement and company expense account usage (credit card) for review of appropriateness and reasonableness of expenses.
- Select a sample of vendors that may require 1099 reporting. Review for W-9 certification. Identify when or if a vendor TIN review was last conducted.

Specific Testing:

- Review access to the Accounts Payable system to determine if individuals who can set up vendors do not also have the capability to pay invoices
- Select a sample of expenses paid or accrued during the year and vouch to supporting invoices, including documentation of approval for payment and classification of expense.
- Through inquiry or observation, review the process for inputting invoices into the Accounts Payable system. Identify the source documents used in this process and inquire if the individual performing the input confirms that the invoice was approved by an authorized individual. Obtain the accounts payable disbursement register and perform the following:
 - For a sample of paid invoices, test to determine that the person who signed the check was independent of the approval of the invoice and the generating of the check. Also review that the general ledger account used for the payment of the invoice is reasonable.
- Through inquiry or observation, review the process for distributing accounts payable (A/P) checks. Determine if the distribution of checks is performed by someone who does not also set up vendors on the A/P system or approve invoices for payment. Review Accounts Payable reports for evidence that the system assists in the identification of possible duplicate payments. Determine what steps area management has implemented to minimize exposure to duplicate payments.

