

Study on Internal Audit of Purchasing Cost Control in Decoration Projects

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Abstract

Purchasing is the basic link in the process of enterprise management and the first link of enterprise cost control. Effective purchasing cost control will not only help the enterprise to reduce costs, but also to improve competitiveness. During the purchasing process, decoration project is facing severe challenges. Purchasing cost cannot be effectively controlled, which results in high cost. As an important part of enterprise internal control, internal audit plays an important role for enterprise management in supervision and evaluation. However, at present, related researches on the internal audit of purchasing cost control in decoration projects are lacking. Therefore, based on the current situation of purchasing cost control in decoration project, the author studied the internal audit of purchasing cost control.

Key word: Purchasing cost control; Decoration projects; Internal audit

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INTRODUCTION

Purchasing is the first link of enterprise cost control. Effective purchasing cost control is essential for business performance. Since purchasing cost accounts for a large proportion of the total cost, in order to ensure healthy and sustainable development of enterprises and

effective purchasing cost control, decoration project must strengthen the control of purchasing operation. Not only pay attention to the financial performance audit, but also strengthen the internal control audit and other aspects; not only carry out post audit, but also pre-audit and concurrent audit, that can reduce audit risk. Internal audit implements the supervision and evaluation for the whole purchasing process, which can timely discover the problems in purchasing, reveal potential risks, and propose targeted solutions and preventive measures, in order to effectively control purchasing cost, and improve economic efficiency and competitiveness.

At present, researches on the internal audit of purchasing cost control in decoration project are shortage. Thus, on the basis of the internal audit theories, the paper studied on internal audit of purchasing cost control in decoration project, hoping to enrich research related to the theory and provide a reference for further research. Meanwhile, that can provide some guidance and reference for the effective purchasing cost control in projects.

1. THE THEORETICAL BASIS OF INTERNAL AUDIT

1.1 The Meaning and Characteristics of Internal Audit

The domestic and foreign auditing field has different understanding and interpretation of internal audit. With the evolution of the concept of internal audit, the understanding about internal audit is deepening. Since the International Institute of Internal Auditors (IIA) was established in 1941, the internal audit definition was constantly revised. In January 2009, revised “International Internal Audit Professional Practices Framework” defines internal audit as

an independent and objective confirmation and consultation, in order to add value and improve the operation of organizations.

By applying systematic and standardized approach, it can evaluate and improve the risk management and the effect of control and governance to help the organization achieve its goals.

In 2003, China Institute of Internal Audit (CIIA) promulgated the first set of internal auditing standards "Fundamental Internal Auditing Standards", in which internal audit was defined as "an independent and objective supervision and evaluation, by auditing and evaluating business activities and the adaptability, legitimacy and effectiveness of internal audit to achieve the goals of the organization".

Compared with the external audit, internal audit has the following characteristics:

a) Internal service

Internal audit is supervision, consultation and evaluation activity in order to promote the enterprise management and economic efficiency. Therefore, internal audit is both the enterprise audit supervisor and the consultation service people.

b) Relative independence

In accordance with national laws and regulations and related guidelines, the staff should independently inspect and evaluate the enterprise management activities throughout the audit process. However, since the internal audit is the audit supervisory organization found by enterprise internal, internal auditors belong to enterprise employees, so that the independence of internal audit is restricted, and internal audit cannot achieve complete independence.

c) Extensive application

Internal audit can not only execute financial performance audit and economic responsibility audit, but also post audit, pre-audit and concurrent audit. It is not only for protection, but also for constructiveness. Audit from all aspects of enterprise management, and strengthen economic management and supervision to achieve operation target.

d) Timely implementation

Under the leadership of the people in charge, internal auditors timely conduct review and evaluation according to the company's specific situation. Meanwhile, based on daily operating conditions, the auditors detect problems in time, reflect those to the relevant person in charge for the first time, and take effective measures to correct the problems and prevent possible risks.

1.2 Function of Internal Audit

As can be seen from the above definition of internal audit, internal audit has some functions, such as supervision, evaluation, control, consultation and so on.

a) Supervision function

Internal audit is a relatively independent internal activity, whose basic function is the supervision function. It is based on financial and system regulations, and on the needs of internal management. Internal audit inspects

the enterprise's financial income and economic activities, supervises the enterprises to comply with financial regulations, and improves the management level and enterprise efficiency.

b) Evaluation function

Evaluation function is another basic function of internal audit. As China's economic development, the evaluation function is increasingly important for the enterprise. By fulfilling the internal audit procedures, and evaluating internal control systems, internal audit puts forward specific comments and suggestions to improve enterprise management and increase the economic efficiency, in order to provide a scientific basis for the management to make the right decisions.

c) Control function

Internal audit is not only an important part of internal control, but also re-controlling of internal control. It can analyze and solve problems on the overall development of enterprises, and provide guidance for the enterprise operation and management to exercise effective control. At the same time, it can inspect the extent and effectiveness of internal control, and put forward possible issues.

d) Consultation function

IIA defined internal audit as an independent and objective confirmation and consultation. Therefore, consultation function is another function of internal audit. Internal audit institutions should provide consulting services for the enterprise management, and propose scientific and reasonable measures for the problems found in the work to avoid business fluctuations and management faults.

2. SITUATION OF PURCHASING COST CONTROL IN DECORATION PROJECT

With the continuous development of society, the number of decorative projects is increasing. Residential buildings, office buildings, shopping malls, train stations and so on all need to be decorated after the completion of construction. Decorative projects are inseparable from material purchasing. The proportion of purchasing cost accounted for the total cost of the project is large, about 65%-80%. However, during the purchasing, the purchasing personnel or project leaders under beneficial temptation might seek personal gain, resulting in a substantial increase of purchasing cost and reducing enterprise profits. By follow-up investigation of Chinese enterprise decoration project, the author found that the status of purchasing cost control is mainly as following aspects.

2.1 Situation of Purchase Planning Management

Decoration projects will carry out purchase planning before purchasing. But, during the planning, there are still

many problems and loopholes, which are not conducive to purchase cost control.

a) Lack of the information collected

Before the purchase planning, the purchasing personnel do not conduct a market survey on purchase prices and suppliers, but develop purchase planning and planned prices directly according to the project budget.

b) Inadequacy of feasibility analysis

After formulating purchase planning, the purchasing staffs do not conduct a feasibility analysis, and write feasibility analysis reports, but directly submit the purchase planning to materials supply departments.

2.2 Situation of Purchasing Bidding Management

Decoration projects purchase mainly by bidding. In the market competition mechanism, the scope and amount of public bidding are growing. There are many problems in the bidding process, which is a serious impact on the effective control of the purchasing cost.

a) Secret operations

Before bidding, projects will query the intentional suppliers for quotations, so close to the base price. In order to make it easier for suppliers to bid, the projects tend to reduce the proportion of business bid scores and increase the proportion of technical bid scores in the solicitation documents.

b) Freely modifying bidding information

Some intentional suppliers don't timely register online, or bidding is not successful. So the projects will extend the bid deadline. Sometimes, projects shorten the bid deadline, and close the registration system after the suppliers completing the registration.

2.3 Situation of Supplier Management

During the purchasing process, there is bad behavior between purchasing staff and suppliers, which potentially increase the purchasing cost and bring about unnecessary losses to the enterprises.

a) Bribing and accepting bribes

Before bidding, project leaders accept bribes of suppliers, and directly select the suppliers, but do not prequalify suppliers as well as investigate and evaluate.

b) Correlative relationship

Sometimes, there exists correlative relationship and other interest relationship between purchasing staff of project leaders and suppliers. Suppliers may raise the purchase price, which makes the purchasing cost too high.

2.4 Situation of Purchase Price Management

In the market economy system, decoration projects are facing with price volatility and other issues during the purchasing process, resulting in the purchase price too high and excessive fluctuations.

a) Price management system has not been established

With the development of market conditions, the purchase price changes from time to time. But the projects

do not establish a price information management system, and cannot access to market information at any time and take targeted market price survey.

b) The information of material price volatility is failed to timely access

During the purchasing process, the projects are often facing with the phenomenon of material price changes. Suppliers may notify projects leaders or purchasing staff when the material prices mark up, but do not inform them when the material prices decline, which results in the purchasing cost too high.

2.5 Situation of Material Storage Management

The quality of material storage management situation greatly affects the purchasing cost of materials. If the storage management is not in place, it would cause serious material losses and a substantial increase in the purchasing cost. However, there are many loopholes on material storage management.

a) Material storage is neglected

There are no dedicated warehouses for material storage. When arriving at Construction Site, the materials are directly unloaded at the site. There is no dedicated staff to take charge, which often emerge material lost and damaged.

b) Material storage is lack of constraints

There is no dedicated staff to record the lost and damaged materials. When materials are insufficient, projects will purchase materials for delivery by suppliers. The remaining material will be sold privately by workers.

3. INTERNAL AUDIT OF PURCHASING COST CONTROL

3.1 Internal Audit Objectives

Controlling the purchasing process aims at reducing purchasing cost and increasing enterprise profits. Internal audit department carries on the audit for purchasing cost control, and its objectives are as follows:

a) By carding the critical control points in the purchasing chain, internal audit will identify weaknesses and aspects needed improvement in the purchasing management, and propose appropriate measures to reduce the management risk and control purchasing cost.

b) The whole process of purchasing should be reviewed and evaluated, including planning management, bidding management, supplier management, price management, and storage management. Internal auditors must detailed review of the purchasing plan, material storage and material consumption records, check the legitimacy and legality of purchasing process, timely detect the risk and loopholes in purchasing management, and ensure the effectiveness of purchasing.

c) By analysis and inspection of the plans and the completion in the purchasing process, internal auditors

should identify and evaluate the potential risks and risk consequence, and then put forward specific proposals.

3.2 Ways of Internal Audit

Purchasing cost accounts for a large proportion of project cost, which has a significant impact on enterprise profits. Effective control of purchasing cost is critical to the enterprises. Therefore, when implementing internal audit for project purchasing, the participatory process audit should be conducted. The participatory process audit refers that internal auditors should be involved in the whole process or part important process of purchasing to achieve daily internal audit of project purchasing. Meanwhile, internal auditors should maintain due independence, and strictly purchasing activities.

3.3 Internal Audit Priorities

3.3.1 Purchasing Plan Management Audit

For the purchasing plan management audit, internal auditors should not be limited to the purchasing plan documents, but should focus on reviewing the following aspects:

a) Before drafting the purchasing plan, review whether the project conducts a market survey on suppliers and purchase prices. Review whether the purchasing plan is formulated based on market forecasts and purchasing decisions to purchase materials.

b) After drafting the purchasing plan, review whether it is reasonable, and whether the feasibility report is issued. Review whether it is connected with the project schedule. Review whether purchasing plan formalities are complete. Review whether the purchase price is reasonable, reviewed and approved.

3.3.2 Purchasing Bidding Management Audit

According to the above analysis of the situation of purchasing bidding management, internal auditors should focus on reviewing the following aspects:

a) Audit the preparation work before bidding

Review whether a sound bidding internal control system is established and implemented effectively. Review whether the bidding procedures and manner accord with relevant systems. Review whether the bidders are provided with bidding qualification. Review whether the bidding notice is publicly released, in which whether the information is complete and accurate. Review whether there is a violation of provisions in the bidding process.

b) Audit the bidding documents

Review whether the content of bidding documents is consistent with the laws and regulations, and makes comprehensive and accurate expression of the actual situation and substantive requirements of the project.

c) Audit the bidding process

Review whether a sound violation punishment system is established and effectively enforced. Review whether the bid opening procedure conforms to the relevant laws and regulations. Review whether bid evaluation standard

is open fair and just. Review whether the calibration procedures and results conform to the relevant regulations. Review whether the contract signed with the successful bidder is contrary to the substantive content of the bidding documents.

3.3.3 Supplier Management Audit

Internal auditors should carry out the supply management audit as the following aspects to improve supplier management efficiency.

a) Audit the basic data of suppliers

Review whether the suppliers have the ability to independently assume civil responsibility, as well as good financial condition and enterprise reputation. Review whether the suppliers have the relevant documents, including business license, tax registration certificate, production license, ISO9000 certification right book, product quality certificate and so on.

b) Audit the supplier selection

Review whether the suppliers are of pre-qualification and inspection. Review whether the supplier selection is reasonable and its program is of specification. Review whether there exists correlative relationship or other interested relationship between project leaders and suppliers. Review whether projects are excessively dependent on a particular supplier, and set up other alternative suppliers.

3.3.4 Purchase Price Management Audit

a) The bidding prices audit

Purchasing staff should fill in “material purchase price declaration form” and submit it to the materials department for approval. Internal auditors should review that whether the “material purchase price declaration form” includes material name, size, type, quantity, unit price, amount, supplier name and so on, and that whether the bidding prices exceed the planned purchase prices.

b) The actual purchase price audit

Review whether the actual price is unanimous with the bidding price. Review whether the bidding program complies with the relevant system. Review whether the actual price is in line with the market price.

3.3.5 Material Storage Audit

For the loopholes of material storage, the following aspects should be audited.

a) A dedicated material warehouse should be established and equipped with warehouse management personnel. Relevant management system should be improved. Internal auditors should review the soundness and effectiveness of the internal control system.

b) The purchasing materials should be taking a physical inventory. Review whether inventory quantities are consistent with the record. Review whether the materials lost and damaged are identified the reasons and timely processed. Review whether material consumption formalities are complete.

CONCLUSION

Purchase business is an important link in decoration projects. Effective control of purchasing cost is the responsibility of purchasing staff, and needs supervision of internal audit departments. Only through mutual coordination and cooperation of every department, can purchase cost be reasonably and effectively reduced, which can bring economic benefits for enterprises. Internal audit should run through the entire purchasing course, including purchasing plans, bidding, suppliers, purchase price and material storage. Only in this way can purchase cost to be able to be reasonably controlled, and purchasing process be effectively standardized.

Thus, decoration project management will be improved efficiency and effectiveness.

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