Katzscan Quarterly

Supply Chain, Governance, Fraud, Turnaround Help

4th Quarter - 2009

I'll be making my list and checking it twice for next year's newsletter content that I think is interesting and nice! :-)

Thank you for allowing me to communicate with you. I hope you find the content informative.

Happy reading - enjoy - and your comments and suggestions are appreciated.

Sincerely,

Norman

Norman Katz, CFE, CFS
Katzscan Inc.
www.katzscan.com

Do you know of a company, *maybe your own*, suffering from disconnected dots?
www.disconnecteddots.com

Let's link! www.linkedin.com/in/katzscan

SUPPLY CHAIN CORNER

Closing Supply Chain Information & Process Gaps

An important goal in creating a well-functioning supply chain is to close information and process gaps, also known as weak or missing links. On the surface this makes good sense, because weak or missing links are where information can get lost or distorted and where inefficiencies and waste breed and grow.

But for public companies there is an added reason that necessitates supply chain integrity: Sarbanes-Oxley compliance. Highlighted in the COSO compliance framework, (public) companies must ensure integrity in operations and computer systems and software applications. Risks must be identified and managed. Information must be accurate and communicated effectively. Controls must be in place to ensure purpose and integrity in business transactions. The stronger the (holistic) supply chain, the better-enabled a company is to produce accurate and timely financial statements.

Let's take a look at a typical slice of the supply chain and, using some affordable and achievable technologies, examine how some critical gaps can be closed:

Let's assume that we are the customer and we issue a purchase order (PO) to a supplier. (This becomes a sales order for the supplier.) We issue our purchase order electronically via Electronic Data Interchange (EDI). Our supplier receives the purchase order and ships our goods, sending an EDI Advance Ship Notice (ASN) at the same time. The ASN tells us what's in the shipment (item and quantity) by pallet and carton. Because we'll get the ASN before the physical shipment, we'll know in advance if the supplier shipped all or part of the order by programmatically comparing the ASN to the PO and reporting any discrepancies. We want to stop problems at the point that they occur -- at the earliest points in our supply chain -- so if the supplier is shipping anything not on the order we want to catch this at the receiving dock. We don't want bad "stuff" (data, raw materials, etc.) infiltrating our supply chain processes or software applications.

When the shipment arrives we should receive it by using an automatic identification method like barcode scanning. (Another auto-id method is radio frequency identification, or RFID.) Now we can programmatically compare the receipt to the ASN to determine if there was any loss during shipment. Comparing the receipt to the PO tells us if the order was shipped complete or short.

With the requirement that the supplier send the invoice via EDI, we can programmatically compare the invoice to the PO to ensure we're being asked to pay for nothing more than was on the original purchase order, but a further comparison to the receipt ensures that we will only pay for what was received, not what was originally ordered.

Further, adding a quality assurance inspection point ensures that we'll only pay for the first quality goods received, not the goods received damaged or those that are sub-standard.

Taking another cue from the COSO compliance framework, this monitoring of the processes and transactions provides the necessary oversight to ensure our supply chain processes and information have integrity and do not risk materially affecting the content of the company's financial statements.

FOCUS ON FRAUD

How Cost-Cutting Can Cause Fraud

In tight economic times companies are looking to cut costs wherever possible. In abundant economic times, companies may look to cut costs to improve financials to appease investors and analysts and boost stock prices and bonuses. Unfortunately, in both cases, too much cost cutting can cause fraud.

Companies have an inherent responsibility to produce products that do not harm their customers. Yet, if costs are cut to such as extreme as to place customers in harms way, the company could be guilty of committing fraud.

The tainted product scandals can be used as examples of cost cutting that could be considered fraud perpetrated by the company, especially those involving lead painted products and those involving the use of melamine to boost protein levels in foods. While the company may not have been able to stop the products from being manufactured as such, were costs cut as to render quality assurance inspections impotent in their ability to catch these frauds?

While it is possible to outsource manufacturing, a company cannot outsource responsibility. The company whose name is on the label has the ultimate responsibility to the customer to produce a product that is safe. A signed piece of paper does not guarantee that a supplier will perform to specifications; the company must ensure through detailed inspections that a supplier's work is first quality.

Cutting perceived overhead may be more like cutting off one's own head to spite the face. Costs should be cut through improvements that drive efficiencies and do not compromise the safety of your customers.

TURNAROUND TIPS

Failure Due To Fraud?

Companies can be in crisis for different reasons, such as the failure to adjust to a changing market, bad decisions on a variety of issues, and fraud. The problem for the turnaround professional can be summed up as follows: You can't fix what you can't see. If you can't see the fraud, how can you fix it? And by failing to see the fraud, will your turnaround repair efforts be continually thwarted? How could this affect the engagement and your reputation?

Frauds as a reason for failure are likely to be more hidden than other reasons for the company's current crisis state. While no one likes to admit to bad decisions, a person is more likely to admit to "screwing up" than to committing fraud.

It is a mistake to think that just by looking at the financial statements and performing vertical and horizontal analysis that fraud will be found. There are many frauds that can occur in a company's internal & external operations (supply chains) that are not revealed on the financial statements. The diligent turnaround professional will use the opportunity when examining the operations and related software applications to identify gaps where fraud can exist, and note these for further investigation.

The existence of fraud can impact the turnaround professional's decision and ability to save a company in crisis. Frauds can cover up manufacturing output, inventory levels, fixed asset values, and other key characteristics that could be important when financing options are considered. The cover-up of the frauds may or may not be reflected in the company's business software applications (i.e. the Enterprise Resource Planning system), and can exist due to poor procedures and overly manual tasks.

GOOD GOVERNANCE

Full Disclosure

Good governance relies on a person's willingness to fully disclose a relationship that could create a bias when making a decision. The relationship can be personal or a business interest.

There is nothing unethical about a business relationship that is based on a personal relationship as long as full disclosure was made prior to the relationship forming. A purchasing manager can buy from a friend or in-law (or their employer) so long as the purchasing manager fully disclosed the relationship prior to contract formalization, and there was relative distance, i.e. the purchasing manager did not approve the contract, distancing themselves from the decision to create the business relationship.

Like relative distance, full disclosure relies on a person doing the "right" thing: revealing that a prior relationship exists between themselves and another party. Sometimes people say they don't understand why such relationships must be disclosed, and that the prior relationship was not a factor in their decision to formalize a contract with the related party. However, time and time again, when these prior relationships are disclosed to the public, we see that more often than not the parties involved benefited beyond that which would appear to be normal, such as a supplier not being fired for sub-standard performance.