



INTERNAL AUDIT REPORT



FINANCIAL SYSTEMS KEY CONTROLS 2016/17

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FINANCIAL SYSTEMS KEY CONTROLS 2016/17

EXECUTIVE SUMMARY

1. INTRODUCTION AND INTERNAL AUDIT OPINION

The Council operates a number of financial systems designed to ensure that transactions are recorded in a timely, accurate and complete manner, free from fraud or error. These systems are often referred to as ‘Key’ or ‘Fundamental’ financial systems. The S151 Officer is required to include a statement in the Council’s annual Statement of Accounts to certify that he has kept proper accounting records that are up to date. Internal Audit control evaluation and compliance testing supports the S151 Officer in exercising this duty.

Appropriate controls are in place for granting and removing access to key financial IT systems and a review of current users identified that effective controls are consistently applied.

Key controls in relation to purchasing of goods and services and payment of suppliers are operating effectively. It was however noted, that monthly Performance Indicator (PI) reporting included inaccurate information with regards to the number of invoices that had been paid with a corresponding Purchase Order (PO). This had resulted in an overstatement of approximately 21% during December 2016.

Payroll transactions were found to be accurate and complete; however, testing did identify three cases of non-compliance with Council policy in relation to enhanced overtime payments. Whilst it is noted that the three enhanced overtime payments had been made in exceptional circumstances, and all payments had been authorised by the relevant service manager, non-compliance with agreed Council policy increases the risk of financial loss and reputational damage to the Authority.

A review of previous audit recommendations found that appropriate management action had been taken in the majority of cases. The remaining recommendations will continue to be followed up as part of the standard internal audit process.

Based on these findings, the framework of controls currently in place provide **Sufficient Assurance** that the identified risks have been appropriately mitigated. Detailed findings are set out in section 2. The assurance opinion is based upon testing of the design of controls to manage the identified risks and testing to confirm the extent of compliance with those controls, as summarised in the table below:

Internal Audit Assurance Opinion	Direction of Travel				
	Risk	Design	Comply	Recommendations	
H				M	L
Sufficient Assurance					
Risk 1: Weak or ineffective system access controls or failure of key financial IT systems	Substantial Assurance	Substantial Assurance	0	0	0
Risk 2: Weak or ineffective controls over purchasing of goods and services and payment of suppliers	Substantial Assurance	Sufficient Assurance	0	1	0
Risk 3: Inaccurate, incomplete or inappropriate payroll transactions	Substantial Assurance	Sufficient Assurance	1	0	0
Risk 4: Failure to implement and sustain improvements arising from previous audit recommendations	Substantial Assurance	Substantial Assurance	0	0	0
Total Number of Recommendations			1	1	0



2. SUMMARY OF FINDINGS

Risk 1: Weak or ineffective system access controls or failure of key financial IT systems

The ICT Security Policy includes matters in relation to system access controls and user responsibilities. System passwords must consist of at least eight characters and include a combination of uppercase and lowercase letters, numbers and non-alphanumeric characters.

The eFinancials system is a fully integrated suite of financial management applications used by Harborough District Council (HDC). With the exception of eProcurement, access to all eFinancials applications is predominantly restricted to Finance staff. Compliance testing undertaken during last year's audit identified that passwords must consist of at least six characters rather than eight; in addition, eFinancials does not currently enforce the use of uppercase letters or non-alphanumeric characters in passwords. At the time of the audit, it was not known whether such password parameters could be enforced via the current system.

Whilst it is noted that all users must comply with Council policies, standards and procedures when setting passwords, enforcement via system parameters would mitigate the risk of non-compliance amongst users. A system upgrade which was due to take place during this financial year has been delayed. Investigations will be undertaken to establish whether such controls can be enforced within the system when the upgrade is underway.

Controls are in place for granting and removing access to key financial systems and a review of current users confirmed that these controls are being effectively and consistently applied. During last year's audit, it was identified that six members of the Finance team had been granted 'Superuser' access to eFinancials. Whilst this level of access is deemed appropriate to their roles, privileged user monitoring does not currently take place, increasing the risk that inappropriate changes to the system could go undetected. It was agreed that privileged user access reporting would be explored during the eFinancials system upgrade. This action is due to be implemented by April 2017 and will continue to be followed up as part of the standard Internal Audit process.

Following a recommendation from the 2014/15 audit, it was agreed that financial system recovery plans would be finalised and communicated to staff. The financial system recovery plans are due to be reviewed and updated by 31st March 2017. This action will continue to be followed up as part of the standard Internal Audit process and no further recommendation will be made.

Based upon these findings, the assurance rating for the controls in respect of this risk is ***Substantial Assurance***.

Risk 2: Weak or ineffective controls over purchasing of goods and services and payment of suppliers

Guidance in relation to the eProcurement system is available to staff via the intranet and training sessions are held for new starters when required. A report detailing all paid purchase invoices for the financial year to date identified that approximately 61% of all non-utility invoices had been paid without a purchase order (PO) as at 9th January 2017. The Finance Services Manager is aware that the level of non-PO invoices remains an area of concern and previously advised that a 'No PO, No Payment' policy would be implemented by 1st July 2016 to improve controls in this area. It is however now expected that this policy will be introduced following the upgrade of the financial system which, as noted above, has been delayed.

Sample testing of 25 paid purchase invoices and corresponding POs identified that the following controls had been exercised:

- All except two POs had been raised at the point of requisition;
- All POs had been appropriately authorised within eProcurement approval limits;
- All invoice details could be matched to the corresponding PO; and
- Confirmation of goods received had been evidenced in all cases.



During the audit, it was identified that monthly performance indicator (PI) reporting of 'payments to creditors within 30 days' did not include accurate information in respect of the number of invoices that had been paid with a corresponding PO. The system reports that were used to obtain this information included multiple line invoices, the impact of which for December 2016 was an overstatement of approximately 21%. The monthly PI report stated that 60% of invoices that had been paid within 30 days had a corresponding PO, when the actual figure was approximately 39%.

It was noted that the relevant system report had been reviewed and revised as at March 2017, however, some further refining was still required. **Recommendation 1** addresses this finding.

Approval limits are set in accordance with pay grades and budget holders are responsible for ensuring that the correct cost centre has been allocated at the point of approval. The eProcurement system has an 'out of office' function which enables budget holders to automatically forward requisitions on to an alternative manager in their absence. This control mitigates the risk of a delay in the eProcurement process.

Agreed tolerance levels exist in order to allow staff to amend the value of POs when required. During the rollout of eProcurement, tolerance levels were originally set at £1,000 or 10% (whichever was lower). Tolerance levels are now based on individual user requirements, for example, to take account of high value penalties imposed for waste contracts or postage and packing costs on low value orders. It should be noted that all amendments to purchase orders must be supported by a written explanation and authorised at the appropriate level.

Creditor invoices are received by post or via email. All invoices are scanned onto eFinancials and a weekly 'automatch' process is undertaken in order to match scanned invoices to corresponding POs. Unmatched invoices (i.e. no goods received / variances) are investigated and resolved accordingly. Non-PO invoices are approved prior to payment and evidence of authorisation is retained on file.

An appropriate separation of duties exists between raising and approving requisitions and the invoice payment process. Following a recommendation from last year's audit, a management review is now undertaken on the BACS Submission Summary report to confirm the accuracy of the total number and value of items processed.

New supplier forms are available via the intranet and all completed forms are saved electronically. Amendments to supplier details (bank / address) are verified by the Payables Assistant by telephone. Following a recommendation from last year's audit, a report detailing all supplier bank changes is now reviewed and approved on a weekly basis.

Based upon the audit findings, the assurance rating for the design of controls in respect of this risk is **Substantial Assurance** and the rating for compliance with these controls is **Sufficient Assurance**.

Risk 3: Inaccurate, incomplete or inappropriate payroll transactions

Leicester City Council (LCC) are the payroll provider for HDC, with delegated responsibility for statutory and pension related deductions. LCC was able to provide documentary evidence to confirm that appropriate checks had been carried out on the majority of annual changes to the payroll system for 2016/17. It was noted that an audit trail did not exist to demonstrate that a check had been undertaken to confirm the accuracy of the HDC employer pension rate, although no errors were identified during testing. LCC advised that this check will be evidenced in future.

The HDC Payroll Officer advised that spot checks had been undertaken on the April 2016 payroll report to confirm the accuracy of transactions. Furthermore, review of an employee payslip confirmed that the gross, net pay and deductions had been calculated accurately.

The payroll Masterfile is not circulated to budget holders in order for them to confirm the accuracy of employee details. This does not, however, currently represent a significant risk as reliance is placed on the effectiveness of compensating controls with regards to new starters, leavers, monthly budget monitoring and review and approval of the monthly payroll report.



Sample testing of 15 additional payments identified that all had been calculated accurately and properly approved. In addition, all 15 payments were agreed to the relevant monthly payroll report. However, it was noted that three enhanced overtime payments included in the test sample were not in accordance with agreed Council policy. In particular, the relevant employees' salaries were above Spinal Column Point (SCP) 28 meaning they were not entitled to receive enhanced payments.

Whilst it is noted that the three enhanced overtime payments had been made in exceptional circumstances, and all payments had been authorised by the relevant service manager, non-compliance with or disregard for agreed Council policy increases the risk of financial loss and reputational damage to the Authority.

Recommendation 2 addresses this finding.

The Payroll Officer conducts a number of on-screen validity checks before the payroll is processed and, for reasonableness, reviews the monthly payroll report provided by LCC. In addition, the monthly payroll report is reviewed by the Finance Services Manager before payments are processed. Exception reports are not provided by LCC because no such reporting functionality is available. This issue has been identified in previous years' audits.

All data is checked prior to loading onto the General Ledger and Collaborative Planning (the Council's budget setting and monitoring system). In addition, monthly payroll reconciliations are completed by the Finance team. A review of the July and December 2016 payroll reconciliations confirmed that all figures agreed to supporting documentation and both reconciliations had been appropriately authorised.

LCC is responsible for processing payroll BACS payments on behalf of HDC and has documented procedures in place for this process. It was noted, however, that the documented procedures held on file needed updating. LCC is in the process of changing its payroll system and has advised that the documented procedures in relation to BACS payments will be updated accordingly.

Appropriate controls are in place to ensure that additions to the establishment and payroll can only be made on receipt of a suitably authorised instruction. The Payroll Officer undertakes appropriate checks to ensure that all details have been input accurately into the payroll system. An appropriate separation of duties is in place, in that all processes undertaken by Human Resources (HR) are checked by the Payroll Officer and vice versa.

Sample testing of five new starters identified that the following controls had been exercised in all cases:

- The appointment form had been formally approved;
- Signed offer confirmations were held on file;
- Appointment details were consistent with payroll records; and
- Salary payments were accurate and in accordance with the relevant appointment.

The Payroll Officer is notified of leavers via HR to ensure that final salary payments can be processed accurately and in a timely manner. Sample testing of five leavers identified that the following controls had been exercised in all cases:

- Leaving dates had been recorded accurately on the payroll system;
- Final salary payments were accurate; and
- The relevant individuals had been removed from the subsequent month's payroll.

Based upon the audit findings, the assurance rating for the design of controls in respect of this risk is **Substantial Assurance** and the rating for compliance with these controls is **Sufficient Assurance**.



Risk 4: Failure to implement and sustain improvements arising from previous audit recommendations

A review of all 2015/16 Internal Audit recommendations identified the following:

- Eight recommendations had been implemented;
- One recommendation was due to be implemented by April 2017 ('Superuser' reporting functionality); and
- One recommendation had not been fully implemented within the agreed timescale (Management review and sign off of control account reconciliations by the end of February 2017).

In addition, it was noted that of the eight recommendations which had been implemented, one required further management action (suspense account balance pre 31st March 2015 to be reviewed and actioned).

A review of two 2015/16 External Audit recommendations confirmed that one had been implemented and the other was expected to be complete by 31st March 2017.

All outstanding recommendations will continue to be followed up as part of the standard internal audit process and no further recommendations will be made.

Based upon these findings, the assurance rating for the controls in respect of this risk is ***Substantial Assurance***.

3. LIMITATIONS TO THE SCOPE OF THE AUDIT

This is an assurance piece of work and an opinion is provided on the effectiveness of arrangements for managing only the risks specified in the Audit Planning Record.

The Auditor's work does not provide any guarantee against material errors, loss or fraud. It does not provide absolute assurance that material error, loss or fraud does not exist.

4. ACTION PLAN

The following Action Plan provides a number of recommendations to address the findings identified by the audit. If accepted and implemented, these should positively improve the control environment and aid the Council in effectively managing its risks.



Action Plan

Rec No.	ISSUE	RECOMMENDATION	Management Comments	Priority	Officer Responsible	Due date
1	<p>During the audit, it was identified that monthly performance indicator (PI) reporting of 'payments to creditors within 30 days' did not include accurate information, with regards to the number of invoices that had been paid with a corresponding PO.</p> <p>It was noted that the relevant system report had been reviewed and revised as at March 2017, however, some further refining was still required.</p>	<p>An appropriate review should be undertaken to provide assurance on the accuracy of information produced in relation to PI reporting of PO and non-PO invoices.</p>	<p>A full review of the data extracts and reports in respect of payments of creditors will be undertaken during 2016/17. Sample checks will be undertaken by the Financial Services Manager on a quarterly basis.</p>	Medium	Financial Services Manager	March 2017
2	<p>Three enhanced overtime payments included in the test sample were not in accordance with agreed Council policy in that the relevant employees' salaries were above Spinal Column Point (SCP) 28.</p> <p>HDC's policy on Pay and Conditions of Service states the following:</p> <p>Additional Hours and Overtime Payments:</p> <p><i>For employees above SCP 28 enhanced rates will not be paid.</i></p>	<p>Overtime should only be paid in accordance with the Council's approved policy on Pay and Conditions of Service.</p> <p>The three cases of non-compliance that have been identified during the audit should be reviewed in more detail by Senior Management to establish whether any further action is required. If the Council decides that such payments should be regarded as acceptable in future then arrangements should be made to seek formal approval to amend the Council's pay policy in this area.</p>	<p>The three payments have been duly authorised by the Service Manager as 'exceptional circumstances'. The Payroll officer will continue to seek written assurances from Service Managers prior to payment.</p>	High	Financial Services Manager	March 2017

Glossary

The Auditor's Opinion

The Auditor's Opinion for the assignment is based on the fieldwork carried out to evaluate the design of the controls upon which management rely and to establish the extent to which controls are being complied with. The table below explains what the opinions mean.

Level	Design of Control Framework	Compliance with Controls
SUBSTANTIAL	There is a robust framework of controls making it likely that service objectives will be delivered.	Controls are applied continuously and consistently with only infrequent minor lapses.
SUFFICIENT	The control framework includes key controls that promote the delivery of service objectives.	Controls are applied but there are lapses and/or inconsistencies.
LIMITED	There is a risk that objectives will not be achieved due to the absence of key internal controls.	There have been significant and extensive breakdowns in the application of key controls.
NO	There is an absence of basic controls which results in inability to deliver service objectives.	The fundamental controls are not being operated or complied with.

Category of Recommendations

The Auditor prioritises recommendations to give management an indication of their importance and how urgent it is that they be implemented. By implementing recommendations made managers can mitigate risks to the achievement of service objectives for the area(s) covered by the assignment.

Priority	Impact & Timescale
HIGH	Management action is imperative to ensure that the objectives for the area under review are met.
MEDIUM	Management action is required to avoid significant risks to the achievement of objectives.
LOW	Management action will enhance controls or improve operational efficiency.