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Dacorum Borough Council - Internal Audit Final Report

Accounts Payable

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1.   Executive summary

1.1. Background

As part of the Internal Audit programme for 2013/14, we have undertaken an audit of the Council's systems of internal control in respect of Accounts Payable.

1.2. Objectives and Scope

The overall objective of this audit was to provide assurance over the adequacy and effectiveness of current controls over Accounts Payable, and provide guidance on how to improve current the controls going forward.

In summary, the scope covered the following areas; Policies, Procedures and Legislation; Creditor Transactions and Records; Standing Data Amendments; Purchase Order Processing; Goods Receipting; Invoice Processing; Payments; Payments Processing; Management Reporting; Security of Data and Follow up of previous recommendations. Further detail on the scope of the audit is provided in Section 2 of the report.

1.3. Summary assessment

Our audit of DBC's internal controls operating over Accounts Payable found that there is a sound system of internal control designed to achieve the system objectives. However, there is evidence that the level of non-compliance with some of the controls may put some of the system objectives at risk.

Our assessment in terms of the design of, and compliance with, the system of internal control covered is set out below.

Evaluation Assessment	Testing Assessment
Full	Substantial

Management should be aware that our internal audit work was performed according to UK Public Sector Internal Audit Standards (PSIAS) which are different from audits performed in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. Similarly, the assurance gradings provided in our internal audit report are not comparable with the International Standard on Assurance Engagements (ISAE 3000) issued by the International Audit and Assurance Standards Board.

Similarly, the assessment gradings provided in our internal audit report are not comparable with the International Standard on Assurance Engagements (ISAE 3000) issued by the International Audit and Assurance Standards Board. The classifications of our audit assessments and priority ratings definitions for our recommendations are set out in more detail in Appendix A, whilst further analysis of the control environment over Accounts Payable is shown in Section 3.

1.4. Key findings

We have raised two priority two recommendations and one priority three recommendation where we believe there is scope for improvement within the control environment. These are set out below:

- Appropriate checks should be carried out on individual suppliers in accordance with

HMRC regulations.

- Purchase orders should be raised prior to acquiring goods / services.

- Potential duplicate payment reports should be produced and reviewed on a regular basis. (Priority 3).

An exercise was carried out in 2012/13 to identify potential duplicate payments. This report was examined and the three highest values were selected and it was identified that in all instances the payment was not duplicated. There had been errors in posting which had been reversed and there was no financial loss to the Council.

Full details of the audit findings and recommendations are shown in Section 4 of the report.

1.5. Management Response

We received the management responses in a timely manner and these have been included in the main body of the report.

We would like to take this opportunity to thank all staff involved for their time and co-operation during the course of this visit.

2. Scope of assignment

2.1 Objective

The overall objective of this audit was to provide assurance over the adequacy of the systems of control in respect of Accounts Payable, with regards the areas set out in section 2.3, are adequate and are being consistently applied.

2.2 Approach and methodology

The following procedures were adopted to identify and assess risks and controls and thus enable us to recommend control improvements:

- discussions with key members of staff to ascertain the nature of the systems in operation;

- evaluation of the current systems of internal control through walk-through and other non statistical sample testing;

- identification of control weaknesses and potential process improvement opportunities;

- discussion of our findings with management and further development of our recommendations; and

- preparation and agreement of a draft report with the process owner.

2.3 Areas covered

The audit was carried out to evaluate and test controls over the following areas:

- *Policy, Procedures and Legislation*

  Staff act consistently in compliance with legislative and management requirements and the administration of the Accounts Payable function is conducted in an economic, efficient and effective manner.

- *Creditor Transactions and Records*

  Reliability, integrity, confidentiality and security of the creditors system and records is maintained through the reliable operation of the system and its interfaces to the main accounting and feeder systems.

- *Standing Data Amendments*

  Additions, deletions and amendments to creditor standing data are completely, accurately and validly processed in a timely manner.

- *Purchase Order Processing*

  Purchase orders placed for goods / services are completely, accurately, validly and timely processed and recorded in line with management requirements.

- *Goods Receipting*

  To confirm that goods / services are appropriately received, processed and recorded in respect of goods / services ordered.

- *Invoice Processing*

  Invoices received are correctly coded, processed and recorded in respect of goods / services received.

- *Payments*

    BACS and Cheque payments to suppliers for goods / services received are completely and accurately made and recorded in line with legislative requirements.

- *Payments Processing*

    Emergency payments to suppliers are processed and recorded in a secure manner.

- *Management Reporting*

    To confirm that creditors' information is produced and secured to facilitate effective monitoring and decision making.

- *Security of Data*

    Creditors' data is adequately protected and unauthorised access to the data is prevented.

- *Follow-up Previous Audit Recommendations*

    To confirm that recommendations raised in the previous audit report have been implemented.

3. Assessment of Control Environment

The following table sets out in summary the control objectives we have covered as part of this audit, our assessment of risk based on the adequacy of controls in place, the effectiveness of the controls tested and any resultant recommendations.

Control Objectives Assessed	Design of Controls	Operation of Controls	Recommendations Raised
Policy, Procedures and Legislation	✔	✔	
Creditor Transactions and Records	✔	✔	
Standing Data Amendments	≈	≈	**Recommendation 1**
Purchase Order Processing	✔	≈	**Recommendation 2**
Goods Receipting	✔	✔	
Invoice Processing	✔	✔	
Payments	✔	≈	**Recommendation 3**
Payment Processing	✔	✔	
Management Reporting	✔	✔	
Security of Data	✔	✔	
Follow Up of Previous Recommendations	✔	✔	

The classifications of our assessment of risk for the design and operation of controls are set out in more detail in Appendix A.

4. Observations and Recommendations

Recommendation 1: Individual Supplier Set Up (Priority 2)

Recommendation

Management should critically review the current process of supplier set up, to ensure that supplier accounts are not inappropriately set up for individuals, who should instead be paid through payroll.

All individuals that are to be set up as suppliers should complete the Business Status Form in full and sign and return to Accounts Payable.

The importance of complying with HMRC regulations around individual suppliers should be communicated across the organisation and confirmed received from Group Managers and above that requirements are understood.

Observation

The HMRC Employment Status regulations states, "A worker's employment status, that is whether they are employed or self-employed, is not a matter of choice. Whether someone is employed or self-employed depends upon the terms and conditions of the relevant engagement. An employed earner is a person who is gainfully employed in Great Britain or Northern Ireland either under a contract of service, or in an office with income chargeable to income tax as employment income. It is a general requirement that those wishing to take on workers consider the terms and conditions of a particular engagement to determine whether the worker is an employee or self-employed."

It was identified that there is no defined process in place for the setup of individual suppliers. Currently, there is no evidence of verification and decision making processes followed by recruiting managers and HR being forwarded to Accounts Payable. Each individual is set up as a supplier upon request and is required to complete a Business Status form, which requires the individuals to confirm employment status , provide relevant tax and national insurance details and sign to confirm obligations towards payment of income tax and insurance contributions.

Examination of a sample of seven individuals identified one instance where an employee on the payroll had also been set up as a supplier, and had been paid for consultancy services (supplier 109191). Insufficient detail was included on the order and invoice as to the services provided and how payment had been agreed, i.e. per hour. At the time of the audit £4,150 had been paid to this individual in October 2013.

It was identified that the Business Status form for this individual had not been completed fully, with the following information missing:

- Name of Business / Self Employed;
- Address;
- Contact Number;
- Business Status (Limited Company, Partnership, Self Employed, Other); and
- Are you registered for VAT; What is your VAT number.

Where HMRC Employment Status regulations are not adhered to, there is a risk of HMRC imposing financial sanctions on the Council. This may lead to additional financial pressures and damage to the reputation of the Council.

Responsibility

Recruiting managers in conjunction with HR

Management response / deadline

Partly agree.

Whilst the recommendation is understood, there is no practical means of mitigating this risk within the Accounts Payable (AP) control system. To do so would require checking the status of all individuals paid through the AP system against the Council's payroll which would not be an efficient use of officer time.

The responsibility for ensuring compliance with HMRC Employment Status regulations and ensuring payments are made through the correct system i.e. Payroll or Accounts Payable more appropriately rests with the relevant Service Manager under the guidance of Human Resources.

This recommendation will be discussed with the Group Manager (People) to identify the most appropriate education and control processes for the future.

Recommendation 2: Purchase Orders Raised and Approved (Priority 2)

Recommendation

Service lines should be formally reminded that purchase orders should be raised and appropriately approved prior to the goods or services being acquired in order to assist with commitment accounting and budgeting.

Consideration should be given to updating the financial regulations to include this as a requirement.

Observation

Purchase orders should be raised when placing orders for goods / services, before receiving the invoice. These are authorised by the Team Leader and once approved, an order number is generated on the system. The Payments Team scans the invoice onto Agresso and once scanned, a transactions number is generated. When the item is received the relevant department will confirm receipt on Agresso and Agresso will then automatically release payment. Any invoice with a 5% deviation from P/O will be sent back to requisitioner to reapprove.

Examination of sample of 20 invoices identified that in eight instances the purchase order had been raised retrospectively once the invoice had been received, namely for:
- PO 4041999 – order dated 04 April 2013, invoice dated 22 March 2013;
- PO 4042078 – order dated 09 April 2013, invoice dated 28 March 2013;
- PO 4042251 – order dated 16 April 2013, invoice dated 15 April 2013;
- PO 4043487 – order dated 18 June 2013, invoice dated 13 June 2013;
- PO 4043918 – order dated 08 July 2013, invoice dated 30 June 2013;
- PO 4045103 – order dated 10 September 2013, invoice dated 31 August 2013; and
- PO 4045145 – order dated 13 September 2013, invoice dated 31 August 2013.

Furthermore, examination of the Financial Regulations identified that, although there is a requirement to raise a purchase order, there is no requirement to raise the order prior to the goods / services being acquired.

Where purchase orders are not raised prior to acquisition of goods or services, there is a risk of inappropriate purchases being made which may result in ineffective commitment accounting and impact upon the budgets available to deliver key services.

Responsibility

Group Manager (Financial Services)

Management response / deadline

Agreed.

The Council's purchase process is scheduled for review in early 2014 which may result in a move away from the PO method. The level of compliance will be reviewed as part of this exercise. In the interim, judgements must be made by Finance managers as to the level of compliance monitoring it is cost-effective to undertake.

Whilst budget monitoring could be improved by including commitments that would arise from full compliance with the PO process, any risk arising from failure to raise PO's is mitigated by monthly meetings between accountants and budget holders and the calculation of a robust forecast outturn position.

For completeness, the Financial Regulations will be updated to explicitly state that POs should be raised in advance. However, this is more of a technicality and is unlikely to result in increased compliance.

Recommendation 3: Potential Duplicate Payment Reports (Priority 3)

Recommendation
Potential duplicate payment reports should be produced and reviewed on a periodic basis, no less than bi-annually.
A minimum value for potential duplicates should be agreed by management for inclusion on these reports and further investigation.
Observation
In order to help ensure that payments have been paid correctly and only once, a potential duplicate payment report should be run on a regular basis. The potential duplicate payments identified should then be reviewed and action taken to recover any over payment as is appropriate.
The Agresso system highlights any potential duplicates where the invoice number or supplier name is the same; however this does not include any differentiation in spelling or format. It was identified that an exercise is carried out every two years upon receipt of a potential duplicate payment report received by the National Fraud Initiative (NFI).
Examination of the report format for one month was produced and it was identified that there are numerous potential duplicates which would be unfeasible to investigate on a regular basis. Furthermore, a number of these potential duplicates were for very small values and would not be cost effective in investigating within the team as this would be identified as part of the NFI exercises.
Where regular exercises are not undertaken to identify duplicate payments, there is a risk that instances of significant duplicate payments will not be identified in a timely enough manner to be able to complete effective recovery action, which may result in financial loss.
Responsibility
Group Manager (Financial Services)
Management response / deadline
Agreed
It is important to stress that there are currently controls in place to identify duplicate payments at the point of entry onto the system. These are augmented by the annual running of a duplicate payment report, which has not identified any duplicates.
A report will be run on a quarterly basis and reviewed to identify duplicate payments over £500. Necessary actions will be taken to recover any monies owed and a record kept of the outcome.

Appendix A – Reporting definitions

Audit assessment

In order to provide management with an assessment of the adequacy and effectiveness of their systems of internal control, the following definitions are used:

Level	Symbol	Evaluation Assessment	Testing Assessment
Full		There is a sound system of internal control designed to achieve the system objectives.	The controls are being consistently applied.
Substantial		Whilst there is a basically sound system of internal control design, there are weaknesses in design which may place some of the system objectives at risk.	There is evidence that the level of non-compliance with some of the controls may put some of the system objectives at risk.
Limited		Weaknesses in the system of internal control design are such as to put the system objectives at risk.	The level of non-compliance puts the system objectives at risk.
Nil		Control is generally weak leaving the system open to significant error or abuse.	Significant non-compliance with basic controls leaves the system open to error or abuse.

The assessment gradings provided here are not comparable with the International Standard on Assurance Engagements (ISAE 3000) issued by the International Audit and Assurance Standards Board and as such the grading of 'Full' does not imply that there are no risks to the stated control objectives.

Grading of recommendations

In order to assist management in using our reports, we categorise our recommendations according to their level of priority as follows:

Level	Definition
Priority 1	Recommendations which are fundamental to the system and upon which the organisation should take immediate action.
Priority 2	Recommendations which, although not fundamental to the system, provide scope for improvements to be made.
Priority 3	Recommendations concerning issues which are considered to be of a minor nature, but which nevertheless need to be addressed.
System Improvement Opportunity	Issues concerning potential opportunities for management to improve the operational efficiency and/or effectiveness of the system.

Appendix B – Staff interviewed

The following personnel were consulted:

Catherine Hamilton   -   Finance Manager
Robbie File   -   Business System Developer

We would like to thank the staff involved for their co-operation during the audit.

Appendix C - Statement of responsibility

Statement of Responsibility

We take responsibility for this report which is prepared on the basis of the limitations set out below.

The matters raised in this report are only those which came to our attention during the course of our internal audit work and are not necessarily a comprehensive statement of all the weaknesses that exist or all improvements that might be made. Recommendations for improvements should be assessed by you for their full impact before they are implemented. The performance of internal audit work is not and should not be taken as a substitute for management's responsibilities for the application of sound management practices. We emphasise that the responsibility for a sound system of internal controls and the prevention and detection of fraud and other irregularities rests with management and work performed by internal audit should not be relied upon to identify all strengths and weaknesses in internal controls, nor relied upon to identify all circumstances of fraud or irregularity. Auditors, in conducting their work, are required to have regards to the possibility of fraud or irregularities. Even sound systems of internal control can only provide reasonable and not absolute assurance and may not be proof against collusive fraud. Internal audit procedures are designed to focus on areas as identified by management as being of greatest risk and significance and as such we rely on management to provide us full access to their accounting records and transactions for the purposes of our audit work and to ensure the authenticity of these documents. Effective and timely implementation of our recommendations by management is important for the maintenance of a reliable internal control system. The assurance level awarded in our internal audit report is not comparable with the International Standard on Assurance Engagements (ISAE 3000) issued by the International Audit and Assurance Standards Board.

Deloitte & Touche Public Sector Internal Audit Limited

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