

The Highland Council
Resources Committee – 25 February 2015

Agenda Item	11(b)
Report No	RES/13/15

Internal Audit Report – Matters Arising from the Statement of Internal Control 2013/14

Report by Director of Finance

Summary

This report provides the outcomes of the Internal Audit's work on the Matters Arising from the Statement of Internal Control

1. Background

- 1.1 The Head of Internal Audit and Risk Management examines the Council's systems of Internal Control to inform his annual Statement of Internal Control.
- 1.2 The following six key areas are the subject of an evidence-based high level review:-
- Control environment
 - Identification and evaluation of risk and control objectives
 - Information and reporting
 - Control processes
 - Monitoring and corrective action
 - Assessment of whether the key controls have been applied during the year

2. Report Findings

- 2.1 The Internal Audit Report can be found at **Appendix 1** and was presented to the Audit and Scrutiny Committee on 20 November 2014.
- 2.2 The Audit opinion concluded for this review was *Substantial Assurance*.

3. Audit recommendations

- 3.1 The Action Plan contains 2 recommendations, one graded at *Medium Priority* and two graded at *Low Priority*.

Medium Priority is described as "important issues that managers should address and will benefit the organisation if implemented".

Low Priority is described as “Minor issues that are not critical but managers should address”.

3.2 The recommendations have all been completed

4. Implications

4.1 There are no Legal, Equalities, Climate Change/Carbon Clever, Risk, Rural or Gaelic implications arising from this report.

Recommendation:

Members are asked to note the findings of the Internal Audit Report on the Matters Arising from the Statement of Internal Control presented to Audit and Scrutiny Committee on 20 November 2014, and the actions taken to implement its findings.

Designation: Director of Finance

Author: David Robertson, Head of Corporate Finance

Date: 3 February 2015

Attachments: Appendix 1 – Internal Audit Report



CONFIDENTIAL

**INTERNAL AUDIT
FINAL REPORT**

HIGHLAND COUNCIL
MATTERS ARISING FROM THE STATEMENT OF INTERNAL
CONTROL 2013/14

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1. MANAGEMENT SUMMARY

1.1 Introduction

In order to inform the Head of Internal Audit & Risk Management's annual Statement of Internal Control, work was undertaken to examine the systems of internal control operated within Highland Council. This consisted of:

- (i) A high level review of the Council's system of internal control by way of an evidence-based checklist comprising six key areas:
 - Control environment.
 - Identification and evaluation of risk and control objectives.
 - Information and reporting.
 - Control processes.
 - Monitoring and corrective action.
 - Assessment of whether the key controls have been applied during the year.
- (ii) A review of the key controls operated within those financial systems which were not subject to a detailed audit review during the year (Debtors, General Ledger, Income and Payroll). The areas examined included:
 - Financial procedures and guidance issued to staff;
 - Segregation of duties;
 - User access levels and appropriateness;
 - System backups and security of data.

A sample of transactions was also selected for detailed testing to verify that the controls were operating as expected. This sample covered the Council, Pension Fund and organisations which use some or all of the Council's financial systems (Assessor's Department, NHS, High Life Highland and HITRANS).

Separate audits of the Creditors and Revenue Budgetary Control systems have been undertaken and these have been reported separately.

1.2 Main Findings

The main finding of the review was that the systems of internal control were reliable. However there were some identified matters where action could be taken by management to improve the internal controls as follows:

- (i) Internal Control Checklist

No issues were identified (Section 3.1).

- (ii) Review of Key controls

The key controls were found to be operating satisfactorily other than the issues noted below.

Debtors (Section 3.2.1)

A sample of twenty four debtor invoices was selected and issues were found where Financial Regulations had not been complied with including:

- The requirement to issue invoices within the specified timescales was not met for seven transactions. This point was also raised in a separate Debtors audit report which was issued on 10/03/14. In response, it was agreed that officers would be reminded of the need to comply with Financial Regulations and this was addressed by the Income & Recovery Manager in February 2014. Further issues were identified from this audit as six invoices were not sufficiently detailed and eight were for regular monthly sums whereby direct debit payments could have been considered.

- Review of seven cancelled invoices showed that four did not contain an accurate reason for the cancellation. Two were not cross referenced to the original invoice. This was also raised in the Debtors audit report and was addressed at that time by the issue of guidance by the Service Finance Manager (Central Services).

General Ledger (Section 3.2.2)

From a sample of ten general ledger code amendments, one Chart of Account request form was not authorised by an appropriate individual.

Payroll (Section 3.2.3)

From a sample of seventeen New Starts and Leavers examined, sixteen were appropriately authorised and seventeen were processed in agreement with the completed payroll forms, although two were not submitted promptly. Lastly, for three, evidence of independent checks could not be demonstrated.

Review of sixteen fixed and temporary payroll changes identified that all were supported by the appropriate documentation where required and the changes input had been checked by an independent officer. All were authorised by an appropriate officer except for four where the signatures were illegible and could not be checked.

From a sample of six processed payroll runs, in one case, the information input was checked by the same officer; therefore segregation of duties could not be demonstrated.

1.3 Conclusion

This review has concluded that the Highland Council's systems of internal control were generally reliable. However, as detailed in the main findings above, there are areas where controls could be further improved. There are a total of 3 recommendations in this report, 1 assessed as medium priority and 2 as low grade priority. The recommendations have been accepted by management, with the agreed action due to be completed by 31 December 2014.

1.4 Audit Opinion

The opinion is based upon, and limited to, the work performed in respect of the subject under review. Internal Audit cannot provide total assurance that control weaknesses or irregularities do not exist. It is the opinion that **Substantial Assurance** can be given in that while there is a generally a sound system, there are areas of weakness which put some of the system objectives at risk, and/ or there is evidence that the level of non-compliance with some of the controls may put some of the system objectives at risk. The levels of assurance and their definitions can be found at Appendix 1.

2. SCOPE, METHOD AND COVERAGE

- 2.1 Details of the procedures in operation were ascertained by enquiry of officers within the Highland Council's and review of documents published on their website.
- 2.2 The audit testing covered the financial year 01/04/12 – 31/03/13 and the key controls examined were as follows. It should be noted that the sample sizes stated cut across all organisations.

Debtors

- Review of procedures issued to staff for the Accounts Receivable system;
- Review of user and authorisation rights within the Accounts Receivable system;
- A sample of thirty paid debtor invoices to ensure that:
 - invoices were issued within the specified timetable;
 - invoices contain the required amount of detail;
 - correct ledger codes were used;
 - invoices were necessary given the type of service and value involved.
- A sample of ten cancellations were reviewed to ensure that:
 - an appropriate reason was given for the cancellation;
 - where a replacement invoice was issued, the details are cross-referenced;
 - cancellation was approved by an appropriate officer, separate to the officer who raised the original invoice.
- A sample of five bad debts was reviewed to ensure that they were authorised and processed in accordance with the policy.
- Review of the procedures for segregation of duties surrounding the raising and posting of invoices, recording income and receipts, raising credit notes, processing write offs and amending debtor accounts.
- Review of the procedures for the back-up of the Accounts Receivable system and the holding of this in a secure environment.

General Ledger

- Review of procedures issued to staff for the General Ledger system;
- Review of access rights within the General Ledger system;
- A sample of ten changes to the chart of accounts was examined to ensure that these were authorised by an appropriate officer;
- A sample of six transfers of information to the General Ledger was selected to ensure that this was undertaken within the prescribed timetable by an appropriate officer and the data was complete and accurate;
- A sample of ten reconciliations was examined to ensure that these were undertaken on time, by an appropriate officer and reviewed by a more senior officer. Any discrepancies identified were investigated and actioned as required;
- Reviewed all suspense accounts to ensure that these had been cleared by the year-end. Also the financial year-end close down timetable was examined to ensure that all relevant items had been cleared and this was recorded;
- A sample of two months of exception reports were selected to ensure that these produced, reviewed and actioned as required;
- Review of the procedures for the back-up of the General Ledger data and the holding of this in a secure environment.

Income

- Review of procedures issued to staff for the collection, receipting and banking of income;
- Review of segregation of duties across cash handling, banking, central monitoring and other finance functions for the same account areas;
- Review of controls over the opening and closing of bank accounts;
- Review of user and authorisation rights within the on-line banking system;

- Review of the procedures for the back-up of AXIS data and the holding of this in a secure environment.

Payroll

- Review of procedures issued to staff for the payroll system including Resource Link;
- Review of user and authorisation rights within Resource Link;
- A sample of ten new starts and ten leavers was selected to ensure that:
 - they were supported by an appropriately authorised SAL1 form,
 - the payroll information input is in agreement with that detailed on the SAL1 form and this was submitted promptly,
 - the information input was checked by an independent officer.
- A sample of five exception reports was selected to ensure that these were produced, reviewed and actioned as required;
- A sample of ten permanent and ten temporary changes was selected to ensure that:
 - these are supported by the appropriate documentation and the information input is in agreement,
 - the documentation was authorised by an appropriate officer,
 - the information input was checked by an independent officer.
- A sample of five processed payroll runs was selected to ensure that control totals were established prior to processing and that:
 - the input control totals were reconciled with the output information,
 - the information input was checked by an independent officer,
- Review of the procedures for the back-up of the Resource Link data and the holding of this in a secure environment.

2.3 Staff involved in the audit were:

- Head of Corporate Finance;
- Principal Accountant, Central Services;
- Accountant, Treasury Management, Leasing & Investments;
- Assistant Manager, Income & Recovery;
- Senior Accounting Technicians, Central Services;
- Senior Systems Administrator, Finance Systems Admin Team;
- Administrative staff from: Finance Service, Chief Executive's Office, Community Services, Care & Learning Service, Development & Infrastructure, Payroll, Highlife Highland.
- Systems Administration Manager, Finance Service.

Thanks are extended to all of these officers for their courtesy, co-operation and assistance in this assignment.

3. FINDINGS AND RECOMMENDATIONS

3.1 Internal Control Checklist

Completion of the 2013/14 Checklist did not identify any issues.

3.2 Review of Key Controls

A sample of items processed through the financial systems was examined whereby the following issues were noted:

3.2.1 Debtors

Debtor invoices:

As outlined in Section 2.2, a sample of thirty debtor invoices was tested. Twenty related to goods and services supplied by a range of Council Services, while the remainder related to other public sector organisations who use the Council's financial systems (High Life Highland, NHS, Pension Fund, Assessor's Department and HITRANS). Of the sample examined, six related to the latter three organisations and have been reported separately. With regard to the remaining twenty four, the main issues related to the failure to comply with the requirements of Financial Regulations and the associated guidance notes on the Issue of Debtor Accounts and Internal Control & Authorisation, or areas where additional guidance is required:

- Financial Regulations state that *"invoices should be raised within fourteen days from the date of the provision of a service, goods or charges, at the month end for regular invoicing or when all associated charges are available."*
 - Seven invoices were not raised within the required time limits with the delay in invoicing ranging from 23 to 217 days.

This issue was also highlighted in a separate Debtors audit report which was issued on 10/03/14. In response, it was agreed that officers would be reminded of the need to comply with Financial Regulations and this was addressed by the Income & Recovery Manager in February 2014.

- Financial Regulations state that *"where invoices are issued, the description of goods and services supplied by the Council, or the reason for invoicing the customer should be complete and instantly recognisable by anyone looking at the invoice"*.
 - Six invoices did not contain the required level of detail.
- Financial Regulations state that *"where regular monthly payments are required eg. commercial rents, accommodation charges etc payment should be made by direct debit"* (i.e. there is no need to issue monthly invoices).
 - Eight invoices related to regular monthly sums where direct debit payments could have been considered.

Cancellations:

Ten cancellations were selected across a range of Council Services. Again, the main issue was the failure to comply with the requirements of Financial Regulations and the two guidance notes referred to above. Of the sample examined:

- Financial Regulations state that *"the reason for issuing the credit note should be recorded on the credit note to provide a clear audit trail as to why invoices were cancelled or reduced in value"*.
 - Four cancelled invoices, although legitimate, did not have the correct reason for the cancellation selected from the pick list on Oracle. For two, "accounts receivable billing error" was selected instead of "cancellation" and, for another, "cancellation" instead of "credit and rebill". Lastly, "incomplete invoice" was selected instead of "replacement invoice".

Again, this point was addressed in the previous Debtors audit report by the issue of guidance by the Service Finance Manager (Central Services).

- Financial Regulations state that *"the credit note should always cross reference to the invoice that it relates to. The respective credit note should be issued to the customer along with any amended invoice."*
 - o For two cancellations, the replacement invoice was not cross-referenced to the original invoice, however this is not a requirement of Financial Regulations.

The above sample included one High Life Highland (HLH) cancellation which could not be established if a replacement invoice was required as no records were held detailing the reason for the cancellation. It was also noted that the invoice and the corresponding cancellation was processed by the same individual. HLH's Financial Regulations state that *"Separation of duties will be introduced so that individuals cannot influence financial transactions from start to finish. Therefore transactions will be progressed in stages by different people. For example, orders could be prepared by one person, received and checked off by a second person, and invoice settlement handled by a third; similarly debtor accounts will be raised, payments received and income controlled in separate offices. With appropriate controls where only a small number of employees are available alternative arrangements with appropriate controls must be agreed with the Head of Resources & Finance Manager."* This point will be addressed separately with the appropriate officers from HLH.

It was separately reported in HITRANS' Matters arising from the Statement of Internal Control 2013/14 audit report, that the Council's Financial Regulations (which HITRANS have adopted) do not specify the timescale for the issue of invoices with accumulated low value onto one debtor invoice. In this case, the invoice covered a fourteen month period and was issued in a different financial year to when the goods and services were provided.

Recommendations:

- (1) The need to comply with Financial Regulations and associated guidance notes should be re-iterated to all concerned. In particular:
 - The importance of applying descriptions of the goods and services supplied or reason for invoicing the customer should be reinforced
 - For regular monthly amounts sums the efficient use of direct debit collection should be considered.
- (2) Financial Regulations and/ or the associated guidance notes should be revised to include additional guidance on:
 - The requirement to cross reference replacement invoices with the cancellation (credit memo) details
 - The recommended timescale for invoicing accumulated low value charges.

3.2.2 General Ledger

From a sample of ten Chart of Accounts (COA) changes, one of these had not been appropriately authorised by a Service Finance Manager.

Recommendation

Chart of Accounts changes should only be accepted following receipt of an appropriately authorised request form.

3.2.3 Payroll

From the sample of ten new starts selected, one was for the Assessor's Department and two were excluded as one was a new Member and the other was an internal transfer from the weekly to monthly payroll. Of the remaining sample of seven new starts:

- One was not authorised;
- Seven were in agreement with the SAL1 forms, however only five were submitted promptly;
- In two cases, it could not be demonstrated that the input data was independently checked as the full payroll forms, including the evidence of checking were not retained on file.

From a sample of ten leavers:

- All were supported by appropriately authorised SAL1 forms and the information input agreed with the forms;
- The payroll was in agreement with the SAL1 leaver form;
- Except for one item, the input payroll information was checked by an independent officer.

A sample of ten permanent and ten temporary changes were selected. Upon examination, four were then excluded as one related to a terminated payroll number, two were expense payments and one related to a minor contractual payment which commenced in 2004 and the supporting paperwork is no longer held. For the remaining sixteen changes:

- Thirteen were supported by the appropriate documentation and three related to contractual payments for which there is no requirement to retain supporting documentation.
- Eight were authorised by an appropriate officer and four items were exempt; one related to a long standing agreement which was authorised by the NHS before the move to the Council and, as noted above, three related to contractual payments and as such, no supporting authorisation documentation was held. Of the remaining four, these signatories were illegible and so could not be checked. However, it is acknowledged that the number of manually signed documents received is decreasing with a number of changes now submitted electronically with a full audit trail.
- Independent checks were undertaken for eleven items in the sample. The remaining items were excluded, being: two payroll processing documents and three contractual payments.

From a sample of six processed payroll runs it was noted that, in one case, the information was input and checked by the same officer, therefore, segregation of duties could not be demonstrated.

Recommendations

- (1) Payroll staff should ensure that all necessary documentation is retained on file to support the information processed, and checks performed, on the payroll system.
- (2) In respect of processed payroll runs, checking of the data input and subsequent output should be undertaken by separate payroll officers.

4. ACTION PLAN

The Action Plan contains **3** recommendations as follows:

Description	Priority	Number
Major issues that managers need to address as a matter of urgency.	High	0
Important issues that managers should address and will benefit the Organisation if implemented.	Medium	1
Minor issues that are not critical but managers should address.	Low	2
Total recommendations		3

REPORT REF.	GRADE	FINDING	RECOMMENDATION	MANAGEMENT AGREED ACTION	IMPLEMENTATION	
					RESPONSIBLE OFFICER	TARGET DATE
3.2.1	Medium	<p>From a sample of twenty four debtor invoices examined, a number of issues were identified where the requirements of Financial Regulations had not been met:</p> <ul style="list-style-type: none"> Seven debtor invoices were not raised timeously. This point has already been addressed by management. Six invoices did not contain enough descriptive detail. Eight invoices were raised for regular monthly sums whereas collection via direct debit could have been considered. One invoice included a number of low value transactions (under £10). Fourteen months had elapsed from the provision of the first supply to when the invoice was raised. 	<p>(1) The need to comply with Financial Regulations and associated guidance notes should be re-iterated to all concerned. In particular:</p> <ul style="list-style-type: none"> The importance of applying descriptions of the goods and services supplied or reason for invoicing the customer should be reinforced. For regular monthly sums, the efficient use of direct debit collection should be considered. 	<p>An email circular will be issued to remind all relevant individuals for the need to apply Financial Regulations when raising of debtor invoices.</p>	Income and Recovery Manager	Completed 26/09/14
				<p>A update to the Financial Regulation Guidance note, Issue of Debtor Accounts, will be circulated concerning invoicing accumulated low value transactions.</p>	Income and Recovery Manager	Completed 07/10/14

REPORT REF.	GRADE	FINDING	RECOMMENDATION	MANAGEMENT AGREED ACTION	IMPLEMENTATION	
					RESPONSIBLE OFFICER	TARGET DATE
3.2.1 (cont'd)		<p>Similar issues were found with the sample of seven cancellations:</p> <ul style="list-style-type: none"> • Four did not contain an accurate and appropriate reason for the cancellation. This point has already been addressed. • Two replacement invoices were not cross referenced to the original credit note/ invoice. 	<p>(2) Financial Regulations and/ or the associated guidance notes should be revised to include additional guidance on:</p> <ul style="list-style-type: none"> • The requirement to cross reference replacement invoices with the cancellation (credit memo) details. • The recommended timescale for invoicing accumulated low value charges. 	<p>The relevant Guidance Note section will be amended for the requirement insert credit memo details onto replacement invoices.</p> <p>Clarification regarding the issue of low value invoices has been detailed in the Financial Regulation Guidance Note, Issue of Debtor Accounts.</p>	<p>Income and Recovery Manager</p> <p>Income and Recovery Manager</p>	<p>Completed 11/11/14</p> <p>Completed 07/10/14</p>
3.2.2	Low	From a sample of ten Chart of Account changes, one was not approved by a Service Finance Manager.	Chart of Accounts changes should only be accepted following receipt of an appropriately authorised request form.	The details on the Chart of Accounts template will be amended as follows: "Authorised by Service Finance Manager or Deputy".	Systems Administration Manager	Completed 31/12/14

REPORT REF.	GRADE	FINDING	RECOMMENDATION	MANAGEMENT AGREED ACTION	IMPLEMENTATION	
					RESPONSIBLE OFFICER	TARGET DATE
3.2.3	Low	<p>From a sample of seventeen New Starts and Leavers:</p> <ul style="list-style-type: none"> evidence of independent checks could not be demonstrated for three, one was not appropriately authorised, and all amounts processed agreed to the SAL1 forms, however, two were not submitted promptly. <p>From a sample of sixteen fixed and permanent payroll changes:</p> <ul style="list-style-type: none"> Three related to contractual payments whereby there is no requirement to retain supporting documentation. Four were not supported by authorised signatories due to being illegible. <p>One of the six payroll runs examined had been processed and checked by the same officer.</p>	<p>(1) Payroll staff should ensure that all necessary documentation is retained on file to support the information processed, and checks performed, on the payroll system.</p> <p>(2) In respect of processed payroll runs, checking of the data input and subsequent output should be undertaken by separate payroll officers.</p>	<p>Sharepoint forms are now used to process changes etc. and are stored in a secure central library.</p> <p>Processing and checking will be carried out by different officers.</p>	<p>Payroll and Pension Manager</p> <p>Assistant Payroll Manager</p>	<p>Completed</p> <p>Completed 31/10/14</p>

Internal Audit Opinion

Level	Definition
Full Assurance	There is a sound system of control designed to achieve the system objectives and the controls are being consistently applied.
Substantial Assurance	While there is a generally a sound system, there are areas of weakness which put some of the system objectives at risk, and/ or there is evidence that the level of non-compliance with some of the controls may put some of the system objectives at risk.
Reasonable Assurance	Whilst the system is broadly reliable, areas of weakness have been identified which put some of the system objectives at risk, and/ or there is evidence that the level of non-compliance with some of the controls may put some of the system objectives at risk.
Limited Assurance	Weaknesses in the system of controls are such as to put the system objectives at risk, and/ or the level of non-compliance puts the system objectives at risk.
No Assurance	Control is generally weak, leaving the system open to significant error or abuse, and/ or significant non-compliance with basic controls leaves the system open to error or abuse.