



**Internal Audit Report**  
**Review of Controls Operating over Accounts Payable**  
**Issued: 21 February 2018**  
**Final Report**

<b>Level of Assurance</b>	The overall control framework is of an average standard. Some weaknesses have been identified in the controls and improvements are possible.
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<b>Table of Contents</b>	
Page 1	Executive Summary
Page 4	Audit Issues and Management Action Plan
Page 10	Definitions of Ratings and Distribution List (Appendix 1)
Page 12	Terms of Reference (Appendix 2)

## Executive Summary

### 1.0 Introduction

All payments to suppliers and other third party organisations are made through the Purchase Ledger of the Council's finance system, Integra. There are approximately 14,400 suppliers listed on Integra of which approximately 3,500 are currently active. 113,028 payments were made in the 2016/17 financial year, amounting to £982 million (this includes Treasury Management payments). There are two interfaces with Integra: from the Council tax system (Open Revenues) and Social Care Case Management system (Mosaic), both of which feed payments directly to Integra.

The ongoing Purchase to Pay (P2P) project is transforming the way transactions are carried out. The P2P Project regularly reports to its own Project Board and to the ISS Project Board as and when required. As the P2P Project is ongoing, there are currently different methods of processing orders and invoices:

#### **1. Integra Purchase Order (currently 80% complete across identified Council Services)**

Any member of staff (who has appropriate permissions) can raise a requisition within Integra. This request is sent by workflow to their authorising manager who may approve, reject or cancel the requisition. If approved by the authoriser, this will turn the requisition into a purchase order (PO) to be issued to the supplier. All authorisations are controlled by authority limits within Integra.

Staff within services will then receipt goods on Integra as and when they arrive by completing a Goods Received Note (GRN). Once the invoice is received and has been registered against the PO, the Creditors team run an invoice matching routine. This carries out a 3 way match between the PO, GRN and Invoice. If all 3 match (within tolerance levels) then the invoice is paid without any further authorisation as this has taken place at the front end of the process.

If the 3 way match is not successful then invoice certification workflow is triggered back to the authorising manager for them to approve the variance, if deemed appropriate.

#### **2. Non-Integra Purchase Order**

Where there is no Integra PO, a green authorisation slip is attached to the invoice and authorised by a manual signature by the appropriate service manager. These are 100% checked by the Creditors team for errors prior to payment processing.

Historically, all invoices have been manually registered on Integra by staff across the Council. The P2P project has recently completed a successful pilot with Housing staff to replace this with the use of scanning and Optimal Character Recognition technology. This new process will also include workflow authorisation of invoices by managers where there is no PO, thus removing the need for the green authorisation slip. This will be implemented across other Council services in 2018.

Payments are subject to Late Payments legislation and have to be paid within strict deadlines. This obligation is contained within a Statutory Performance Indicator (SPI) which the Council has to report on nationally each year. The definition of the SPI for invoice payments within 30 days changed significantly from 1 April 2017 meaning that the SPI cannot be compared with previous year's data.

## **2.0 Objectives of the Audit**

The objective of the audit was to provide an opinion on the adequacy of controls over payments to suppliers through the Accounts Payable (Integra) system. A copy of the terms of reference for the review is attached at Appendix 2.

## **3.0 Conclusion**

During the audit we focused on payments processed through the Accounts Payable system made in the 2016/17 Financial Year. A number of key controls were seen to be operating and these include:

- the Council sends and receives notifications from other local authorities to be aware of fraud attempts that have occurred in their area. The Council will also inform the bank if there have been any attempted frauds;
- the Integra system will alert a user registering an invoice if a duplicate invoice number is keyed in for the same supplier;
- two payment files are processed per week allowing flexibility for services to arrange making payments;
- there are procedures on change of bank details in the Payment Guidelines and staff are aware of the Financial Regulations and Payment Guidelines. Procedure notes cover the authorisation of orders and invoices before payment and the timely payment of invoices;
- there is segregation of duties between staff processing invoices and those paying those invoices which is further improved with the introduction of new processes through the P2P project;
- a payment run checklist is used to process payments and is retained for audit trail purposes;
- financial reconciliations are undertaken on a daily basis;
- remittances are only emailed to suppliers which reduces administration costs;

## Midlothian Council - Internal Audit – Accounts Payable

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- only a limited number of staff can make changes to the Integra system;
- a new supplier E-form has to be completed by the service and approved by Procurement before a new supplier is set up on the payments system;
- a Construction Industry report is run to identify tax payable to HMRC; and
- training is provided when systems are updated.

We have made recommendations where control issues were identified and these are also noted within the Audit Issues and Management Action plan but briefly relate to:

- Internal Audit testing identified 23 potential duplicate payments totalling £12,087. As at 20/02/18, 18 payments totalling £11,072 had been returned or credited with 5 outstanding payments totalling £1,015 still being pursued with the relevant suppliers;
- the supplier change report had not been checked following an upgrade to the system in October 2016. It has been advised that in January 2017, when Management discovered these checks had not been carried out, every change was checked by a member of staff independent of the Creditors team;
- audit testing identified some change of supplier detail forms had not been countersigned in the period prior to October 2016;
- services are continuously using the sundry supplier code for regular payments to suppliers. Procurement procedures stipulate that the service should complete a 'New Supplier' form to set the supplier up on the system if regular payments are due to be made;
- the Creditors team do not have any specific business continuity plans and rely on the Digital Services business continuity plan;
- a number of supplier change request reports and financial reconciliation reports could not be located indicating that either the controls were not undertaken or the reports are missing. Management have advised that all reports will be scanned;
- there are no procedures for setting up new suppliers and deactivating suppliers on the Integra system. There are details on the Procurement Intranet page on how to request for new suppliers to be added to the system but this is information relevant for services; and
- 2 invoices (dated March 2017) from a testing sample of 12 were not scanned onto the system. Management advised all invoices should be scanned immediately following a payment run.

As noted above, some weaknesses have been identified in the controls and improvements are possible. Therefore we have on this occasion rated the review as **average** as per the definitions on page 10. This is at a time of significant change and challenge for those involved in the accounts payable process who should be commended on their efforts and results in that operating environment. We have raised one High, eight Medium and four Low rated recommendations which are detailed in the Audit Issues and Management Action Plan to reduce risk further and these recommendations have been agreed by Management.

## 4.0 Audit Issues and Management Action Plan

### 4.1 Duplicate Payments

A data match of all payments made in 2016/17 identified 23 potential duplicate payments totalling £12,087. As at 20/02/18, 18 payments totalling £11,072 had been returned or credited with 5 outstanding payments totalling £1,015 still being pursued with the relevant suppliers.

Management have advised that every duplicate payment has been analysed and there is no specific pattern arising ie the overpayments have arisen for a variety of reasons. Business Services managers will discuss with each employee involved in the duplicate payments to determine their role in the payment process, why it happened and what action needs to be taken going forward to prevent any future duplicate payments being processed. In addition, an email reminder will be issued to staff advising that invoices must not be copied as that is one of the reasons why duplicate payments may arise.

No	Recommendation	Priority	Manager	Target Date
1	<p>The duplicate payments identified by Internal Audit need to be investigated by the Payments Team Leader and recovery of any overpayments to suppliers identified should be undertaken.</p> <p><u>Management Comment:</u> Management, in liaison with Internal Audit, will put in place with immediate effect further data matches of payments to identify duplicate payments and take appropriate action.</p>	High	Business Applications Manager	Complete

### 4.2 Change of Supplier details

A security protocol is set up for when a supplier wishes to change their details, including bank details, which staff must follow. The Supplier Change report highlights changes to bank accounts and is required to be reviewed on a weekly basis. Any supplier changes made by the Creditors team need to be checked independently by another member of staff within the Creditors team. There are 10 system admin users who have access to all of the programs in Integra including changing supplier details. This is why changes to supplier details should be independently checked on a regular basis to ensure changes made to supplier details are genuine.

The supplier change report had not been checked following an upgrade to the system in October 2016. It has been advised that, in January 2017, when management discovered these checks had not been carried out, every change was checked by a member of staff independent of

the Creditors team. In addition, audit testing identified some change of supplier detail forms had not been countersigned in the period prior to October 2016 and supplier change reports were not adequately filed. For other supplier changes, the supplier change report is checked on a regular basis by the Creditors team and there is a segregation of duty in place to ensure that staff in the Creditors team do not check their own changes.

In April 2017 additional secure payments functionality was procured and introduced in Integra. Any changes to supplier bank account details suspends the account for that supplier until the change is authorised in Integra by another member of staff. No payments can be made to the supplier until the change is authorised. The authorisation of these changes is completed by staff outwith the Creditors team. There is also a process in place which involves staff contacting the supplier to confirm any change of bank details and this involves asking a number of security questions (eg amount of last invoice) which must be answered correctly to enable the change to be validated. This information is recorded on the change of bank details forms.

No	Recommendation	Priority	Manager	Target Date
2	All supplier change reports should be scanned to provide a suitable audit trail.	Low	Business Applications Manager	30 June 2018

### 4.3 Sundry Supplier

It is the responsibility of each service to request approval from Procurement to use a non-contracted supplier and payments through the sundry supplier code should only be for one off payments. Services are required to complete a 'new supplier form' (or from September 2017 they are required to complete an E-form) which is checked and approved by Procurement who instructs the Creditors team to add the supplier onto the purchase ledger. The supplier form is a key control in ensuring that only approved suppliers are paid. The following issues were identified:

- In 2016/17, 2,792 payments were made through the sundry supplier code amounting to approximately £1.7M. Testing identified that services are continuously using the sundry supplier code for regular payments to suppliers and are not following the procurement procedures. For example, six payments were made to one supplier in 2016/17 (via the sundry supplier code) which totalled £13,488. The Creditors team checks Sundry Supplier payments in excess of £3K on an ad hoc basis; and
- there are no procedures for setting up new suppliers and deactivating suppliers on the Integra system. There are details on the Procurement Intranet page on how to request for new suppliers to be added to the system but this is information relevant for services.

## Midlothian Council - Internal Audit – Accounts Payable

No	Recommendation	Priority	Manager	Target Date
3	<p>Sundry payments should continue to be monitored and services challenged where it is used to pay suppliers for more than one off payments.</p> <p><b>Management Comment:</b>                      Actions have already been put in place by Management. In October and December 2017, emails were issued to all staff advising that sundry suppliers should be used for one off payments and going forward there will be stronger scrutiny and challenge of invoices raised using the sundry supplier code.</p>	Medium	Business Applications Manager	Complete
4	<p>Guidelines for setting up new suppliers and de-activating suppliers on the Integra system should be in place within the Creditors section.</p>	Low	Business Applications Manager	30 Sept 2018

### 4.4 System Issues and Business Continuity

The development of Integra via the P2P project has significantly improved purchasing arrangements across the Council. The ability to authorise purchase orders is controlled by the authorisation hierarchy which should reflect limits within the Authorised Signatories Database. A list of authorised users on Integra was obtained and the following issues were identified:

- two leavers were identified as system users. Business Applications staff receive a leavers' report from Human Resources but as Integra is driven by Active Directory permissions there is no separate username and password required to login;
- staff access rights to Integra are not being regularly reviewed. However it was advised that staff receiving training on Integra will have had their access rights checked at the time of training;
- the Integra authorisation hierarchy was not aligned with the Authorised Signatory Database. Audit testing found 3 employees (from a sample of 15) who had lower limits on the Integra system than on the Authorised Signatory Database (one of these employees is a Head of Service); and
- the Creditors team do not have any specific business continuity plans and rely on the Digital Services business continuity plan. This may result in payments to suppliers being delayed if there was a long term issue with the systems.

## Midlothian Council - Internal Audit – Accounts Payable

No	Recommendation	Priority	Manager	Target Date
5	Once the Purchase to Pay project is complete, user access rights to Integra should be regularly reviewed.  <u>Management Comment:</u> Management will review user activity on a regular basis and check when an employee was last logged in. Any user accounts not active for more than 6 months will be de-activated.	Medium	Business Applications Manager	30 June 2018
6	Authority limits in Integra need to reflect authority limits in the Council's Authorised Signatory Database.	Medium	Business Applications Manager	Complete
7	An operational business continuity plan should be in place for the Creditors function.	Medium	Business Applications Manager	31/03/19

### 4.5 Financial Reconciliations

#### 4.5.1 Control Accounts

- The control account includes all credits and invoices that were processed through the purchase ledger. Totals from the daily purchase ledger control report are reconciled to the totals from the general ledger. There is a difference of £1,010 between the Purchase Ledger and General Ledger (this amount has remained constant since at least 2003). We noted that the Payments Team Leader and other staff in the Creditors team process the payment file on the Purchase Ledger and the Payments Team Leader reconciles the total values to the General ledger. A lack of segregation of duty can increase the risk of errors and fraud. However, invoices are registered on Integra and authorised by services.

#### 4.5.2 VAT reconciliations

- The VAT amount from the invoice is entered on the Integra system when the invoice is registered by the service and errors are checked by the Payments Team Leader. The figures from the VAT report are reconciled to the General Ledger by the Payment Group Leader, and if there are any exceptions, these are investigated. Testing identified minor VAT errors which the Payment Team Leader reviews and checks. However there is lack of information on how immaterial exceptions were investigated and it was found that reconciliation reports had not always been signed off.



### 4.5.3 Local Procedures and Financial Records

- The Purchase Ledger control account reconciliations are undertaken by the Payments Team Leader. It was found that there are a lack of local procedures in the Creditors section on how to undertake financial reconciliations. This is not considered as a significant issue as the Payments Team Leader has been in post for over 20 years. However, the aim of local procedures is to establish guidelines for new Creditors' staff to allow them to undertake their duties in an efficient and secure manner.
- A number of financial reconciliation reports could not be located indicating that either the controls were not undertaken or the reports are missing. Management have advised that all reports will be scanned.
- There was a lack of evidence to show which members of staff had checked the financial reconciliation reports.

### 4.5.4 Purchase Order Control Accounts reconciliations

- When the system was initially implemented, the Lead Applications Officer undertook the Purchase Order commitment reconciliation and the Goods Received Note (GRN) reconciliation. The Purchase Order commitment confirms the outstanding Purchase Order with the Invoice Balance and the GRN confirms goods received but not invoiced. It was advised that the Purchase Order control account has been reconciled to September 2017 but has since not been able to be reconciled. This has been recognised as a bug by the software supplier. These reconciliations are part of the overall system controls but have no impact on the Balance Sheet.

No	Recommendation	Priority	Manager	Target Date
8	All Control Account reconciliations should be authorised by a line manager on a regular basis.	Low	Business Applications Manager	30 Sept 2018
9	Exceptions and errors identified on the reconciliation reports needs to be noted and signed off.	Low	Business Applications Manager	30 Sept 2018
10	Local procedures for undertaking VAT and Control reconciliations should be generated and an adequate filing system should be in place.	Medium	Business Applications Manager	30 Sept 2018
11	Once the current issue is resolved by the software supplier, Purchase Order Control Account reconciliations should be brought up to date.	Medium	Business Applications Manager	30 Sept 2018

## 4.6 Administration

During our audit testing we noted the following Issues:

- 2 invoices (dated March 2017) from a testing sample of 12 were not scanned on the system;
- Internal Audit testing of the VAT spreadsheet provided by Creditors highlighted 21 suppliers with invalid VAT numbers. Testing results were sent to the Payments Team Leader for further investigation which revealed that 14 VAT numbers have been incorrectly input, 6 suppliers were incorrectly included on the VAT spreadsheet as they do not claim for VAT on their invoices and 1 supplier has not been used since 2015. The Council should ensure that suppliers have a valid VAT registration as HMRC may impose an administration penalty if an error is discovered during an inspection; and
- the Integra system holds historic records which have not been archived and the Hague Premier Cheque printing programme holds a record of all previous print logs dating back to 2010. Management are aware that this is a computer system issue that is not compliant with the Council’s retention period, which only allows services to keep records for 6 years, nor will it meet requirements of the new General Data Protection Regulation (GDPR) which comes into force in May 2018, requiring a longer-term solution.

No	Recommendation	Priority	Manager	Target Date
12	Invoices should be scanned on a timely basis.  <u><b>Management Comment:</b></u> Invoices are scanned immediately following the twice weekly payment run assuming resources allow. The P2P project is introducing the use of scanning and Optimal Character Recognition technology which will be implemented across the Council in 2018.	Medium	Business Service Manager	Complete
13	The incorrect Supplier VAT numbers identified by Internal Audit need to be corrected in the supplier record in Integra.	Medium	Business Applications Manager	Complete

**Definitions of Ratings**

**Audit Opinion**

Level of Control	Reason for the level of Assurance given
<b>Excellent</b>	The control framework is of a high standard with no unacceptable risks identified.
<b>Good</b>	The control framework is of a good standard with only minor elements of risk identified which are either accepted or being dealt with by management.
<b>Average</b>	The overall control framework is of an average standard. Some weaknesses have been identified in the controls and improvements are possible.
<b>Weak</b>	The control framework is weak and requires improvement as significant issues exist with the adequacy and effectiveness of the Internal Control arrangements. These control deficiencies could result in delivery of poor service or disruption to service to the residents of Midlothian, financial loss or reputational damage to the Council.
<b>Poor</b>	The control framework is inadequate or ineffective and the issues identified require immediate attention to prevent the delivery of poor service or disruption to service to the residents of Midlothian, financial loss or reputational damage to the Council.

**Recommendation Rating**

Priority	Risk Definition
<b>High</b>	Legal / regulatory issues would normally be regarded as high risks.  Strategic risks would normally be regarded as high risks.  Financial impact - £50K plus and / or national press interest
<b>Medium</b>	£5K - £49K and / or local press interest
<b>Low</b>	Under £5K and / or no press interest.

## **Distribution**

- Kenneth Lawrie, Chief Executive
- John Blair, Director, Resources
- Gary Fairley, Head of Finance and Integrated Service Support
- Jacqui Dougall, Business Services Manager
- Mike O'Rourke, Business Applications Manager

## **Audit Team**

Author: Amber Ahmed, Auditor

Reviewer: Elaine Greaves, Principal Internal Auditor

**TERMS OF REFERENCE:**

**Audit Objective**

The objective of this audit is to form an opinion on the adequacy of controls over payments to suppliers through the Accounts Payable (Integra) system.

**Scope of Audit**

The audit will review the following areas:

1. the controls in place to limit the risk of payment errors and / or fraudulent payments (including authorisation of payments, control of supplier lists, system access and adequacy of audit trails);
2. the controls in place to allow payments to be accurately accounted for in the financial systems; and
3. business continuity arrangements in place should the systems used to process accounts payable be unavailable.

**Excluded from Scope**

- Petty cash payments which have been subject to separate review;
- Payments made via purchase cards which will be subject to separate review;
- Mosaic (social care payments) and TOTAL Mobile (property maintenance, roads and fleet payments) which will be subject to separate review; and
- Payroll and Treasury payments made through the Integra system which are subject to separate review.

**Potential Risks**

Principal potential risks are:-

- Financial loss caused by fraudulent payments, payments made to invalid suppliers or invalid invoices ;
- Financial loss due to errors in payment amounts / duplicate payments which cannot be recovered;
- Supplier complaint, reputational damage and loss of discounts due to untimely payments;
- Incorrect Management decisions/reporting due to inaccurate/inadequate Management and financial information; and

## Midlothian Council - Internal Audit – Accounts Payable

- Unauthorised access/amendments or loss of data due to poor access controls or inadequate business continuity arrangements with the Integra system.

### Audit Approach

The audit approach consists of:

- fact-finding interviews with key employees;
- review of each of the risk exposures and risk treatment;
- closure meeting with local management to discuss the findings and any recommendations from the review;
- draft and final reporting; and
- presentation to the Audit Committee.

### Timescales & Reporting

The audit will commence in late January 2017 and will be reported to the next available Audit Committee.

Any issues arising will be communicated directly to local management as they are identified. A formal audit report will be produced summarising the findings and any recommendations identified during the review.

### Information Requirements

Access to all relevant systems, documentation and employees.

### Audit Staff

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