

Item: 6.1

Monitoring and Audit Committee: 6 June 2019.

Internal Audit Report: Creditors.

Report by Chief Internal Auditor.

1. Purpose of Report

To present the internal audit report on procedures and internal controls relating to ordering, receipt and payment of goods and services.

2. Recommendations

The Committee is invited to note:

2.1.

That Internal Audit has undertaken an audit of the processes and procedures relating to the payment of creditors.

2.2.

The findings contained in the internal audit report, attached as Appendix 1 to this report, relating to the payment of creditors.

It is recommended:

2.3.

That the Committee review the audit findings to obtain assurance that action has been taken or agreed where necessary.

3. Background

3.1.

The system for payment of creditors is one of the most important financial systems within the Council with a total of around 50,000 invoices and credit notes, having a total amount of approximately £65,000,000, processed in the previous financial year of 2017 to 2018. The process involves:

- The raising of purchase orders.
- Receipt of goods or services.
- Invoice checks and processes.
- Supplier reconciliations.

4. Audit Findings

4.1.

The audit provides good assurance that the processes and procedures relating to creditors are well controlled and managed.

4.2.

The internal audit report, attached as Appendix 1 to this report, includes five medium priority recommendations within the action plan. There are no high-level recommendations made as a result of this audit.

4.3.

The Committee is invited to review the audit findings to obtain assurance that action has been taken or agreed where necessary.

5. Corporate Governance

This report relates to the Council complying with its governance and financial processes and procedures and therefore does not directly support and contribute to improved outcomes for communities as outlined in the Council Plan and the Local Outcomes Improvement Plan.

6. Financial Implications

There are no financial implications associated directly with the recommendations to this report.

7. Legal Aspects

Complying with recommendations made by the internal auditors helps the Council meet its statutory obligations to secure best value.

8. Contact Officers

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9. Appendix

Appendix 1: Internal Audit Report – Creditors 2018 to 2019.



ORKNEY
ISLANDS COUNCIL

INTERNAL AUDIT

Creditors

Audit Report

2018/19

Draft Report Issue Date: 06 March 2019
Final Report Issue Date: 08 April 2019

Distribution:
Payments Manager
Corporate Finance Senior Manager
Head of Finance

Contents

| | |
|-------------------|---|
| Executive Summary | 1 |
| Introduction | 2 |
| Audit Scope | 2 |
| Audit Findings | 3 |
| Action Plan | 5 |

EXECUTIVE SUMMARY

- Based on our findings, our review of the processes and procedures as to creditors provides good assurance that processes are well controlled and managed.
- Several areas of good practice were identified during the audit including:
 - Invoices are only accepted by the Payments section if they appear legitimate and show the details of the supplier, quantity and details of the goods/services, value of the invoice, and a VAT registration number is recorded where applicable.
 - Detailed checks are carried out by Officers within Payments to verify that the invoice is marked as checked and is suitably authorised and agrees to the supporting order which is also checked as being suitably authorised.
 - Where invoices do not pass each check, all documentation is returned to the Service with clear explanation as to the missing requirement.
 - An established processing timetable of invoices for payments which is strictly adhered to.
 - Thorough checking of every payment generated against invoices, payment runs are reconciled and approved, each individual payment over £20,000 is counter approved by an Officer outwith the payments Section.
 - Where possible, segregation of duties exists between the ordering of goods/services, receiving the goods/services and the authorisation of invoices for payment. All transmissions of BACS payments are carried out independently of the payments section by the accountancy section.
 - Back-up copies of data are taken on a nightly basis and at the time of the audit recently restored to the test system, this being a replica of the live system.
- Our audit has also identified areas where procedures and internal control arrangements could be further strengthened. There are no high-level recommendations made as a result of this audit.
- The report includes recommendations which have arisen from the audit. The numbers of recommendations are set out in the table below under each of the priority headings. The priority headings assist management in assessing the significance of the issues raised. The report includes 5 recommendations which have been made to address the medium priority issues identified.

| Total | High | Medium |
|-------|------|--------|
| 5 | 0 | 5 |

- Responsible officers will be required to update progress on these agreed actions via Aspireview.
- The assistance provided by officers contacted during the audit is gratefully acknowledged.

INTRODUCTION

The system for payment of creditors is one of the most important financial systems within the Council with a total of around 50,000 invoices and credit notes, having a VAT inclusive total amount of approximately £65 million, processed in the previous financial year of 2017/2018.

Council purchase orders for goods and services are raised within the service departments; the service departments receive the goods and resultant purchase invoices. The purchase invoices are checked, coded and certified within the service department. Processes to property specific costs are generally carried out electronically using the Concerto software system and are interfaced into the Finance integrated ledger system, Integra2. All other invoices and credit notes, being approximately 47,000 of the above total were processed manually and are physically passed to the Payments Section for payment with the second copy of the order attached. These invoices, if approved and matched by Services against a purchase order or appropriate supporting documentation are keyed into the Integra2 system.

The Integra2 system processes all invoices and produces the data for supplier payment.

The ongoing project to implement purchase to pay is generally outwith the Scope of this Audit.

AUDIT SCOPE

The purpose of the audit was to determine the following:

- The procedures and internal controls in place for the creditors system.
- That payments are made only for goods and services which were the subject of authorised orders.
- That payments are made only for goods and services that are received.
- That all invoices are properly authorised and passed for payment and then paid in a timely manner.
- That payments are made only to valid creditors.
- That payments are correctly recorded in the financial ledger.

Audit Findings**1.0 Processes**

- 1.1 Our internal audit found procedural documentation to be generally comprehensive and well structured. Procedural documentation was available to all Officers within the Payments Section on the electronic network.
- 1.2 The procedural documentation does however show a few signs of requiring refreshment, e.g. the details recorded for a Signatory were out of date,
- 1.3 It is recommended that the procedural documentation be refreshed periodically.

Recommendation 1

- 1.4 One invoice was processed reclaiming a small amount of VAT, £48.33, where the invoice issued by the supplier was technically invalid due to being just over the limit and a full rather than simplified vat invoice should have been issued by the supplier.
- 1.5 It should be considered whether guidance is included in the procedural notes as to what constitutes a valid VAT invoice and can be accepted. Relevant Offices should be updated as to the criteria which must be included on an invoice for it to be valid.

Recommendation 2

- 1.6 From a focused test, using data analytics over all invoices processed in the year so far to identify all invoices that were of a high risk of duplicate payment, by selecting invoices from the same supplier, dated the same day, for the same amount, with similar reference numbers identified 6 low value invoices which were processed twice and in five of the instances paid twice. In total the duplicate payments identified totalled an overpayment of £290.35. This money will be recovered in full by either requesting a refund or making deduction from the next payment to the supplier.
- 1.7 The Council's financial regulations detail, at 12.4.2., that certifying officers must ensure that duplicate payments are not made. In all twelve certifications leading to the 6 duplicate payments, were made by original signing of initials within the Service. Integra2 has in built functionality which will reject the posting of an invoice which uses a repeated reference number from the same supplier. In at least some of the instances identified at 1.6 it seems that this control was overridden by entering a full stop at the end of the reference number. The Payments Manager confirmed that in some instances the reference number control will be overridden due to the frequent occurrence of suppliers repeating invoice numbers where both invoices are bona fide, and should both be paid.
- 1.8 The overriding of system generated rejection of duplicated invoice numbers should only take place in a controlled manner.
- 1.9 It should be considered that the process notes are updated to clarify when the system control on replicated invoice numbers may be overridden and the level of investigation to be carried out of a previous payment, possibly for various value bands of invoice.

Recommendation 3

Audit Findings (Continued)

- 1.10 Reconciliations between supplier statements and internal records are currently being performed on an ad hoc basis, dependent largely on resource availability when Officers have completed higher priority tasks. Reconciliations to supplier statements, whilst primarily focused towards identifying any outstanding invoices and that payments have been correctly made, received and processed, may also identify fraudulent activity.
- 1.11 It is recommended that a focused programme of performing Supplier Reconciliations be carried out to complement the Council's overall creditor system controls.

Recommendation 4

- 1.12 A test sample found purchase orders were often not fully completed. Where necessary Invoices and Purchase Orders are returned by payments to Services for proper completion.
- 1.13 Purchase Orders should be completed properly throughout the Council. It is anticipated implementation of Purchase to Pay and associated training will assist in meeting this requirement.

Recommendation 5

| | Recommendation | Responsible Officer | Management Comments | Agreed Completion Date |
|---|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------|
| | Policy and Procedures | | | |
| 1 | Procedural documentation should be refreshed periodically. Medium Priority | Payments Manager | A suite of guidance documents is being produced to support the implementation of the Purchase to Pay system. These documents will then be subject to periodic review. | September 2019 |
| 2 | It should be considered whether guidance is included in the procedural notes as to what constitutes a valid VAT invoice and can be accepted. Relevant Offices should be updated as to the criteria which must be included on an invoice for it to be valid. Medium Priority | Payments Manager | Key staff within the Payments Team attended VAT training in December 2018 which covered this point. Procedure notes being developed shall include guidance on the format of valid VAT invoices. | September 2019 |
| 3 | It should be considered that the process notes are updated to clarify when the system control on replicated invoice numbers may be overridden. Medium Priority | Payments Manager | The Purchase to Pay system shall introduce a new method for the payment of invoices with improved system controls. Invoices shall have to be matched to individual electronic purchase orders which can only happen once. The checks required on duplicate invoice numbers from suppliers shall be included in the guidance documents. | September 2019 |
| 4 | A focused programme of performing Supplier Reconciliations should be carried out more regularly. Medium Priority | Payments Manager | Supplier statements will be checked on a more regular basis. This will be facilitated with the Purchase to Pay system as the Payments Team shall receive invoices centrally and have improved information on outstanding invoices which is currently not available. | December 2019 |
| 5 | Purchase Orders should be completed properly throughout the Council. Medium Priority | Payments Manager | The Purchase to Pay system shall introduce the use of electronic purchase orders throughout the Council. The system shall have inbuilt controls which ensures required fields will be completed. This shall replace the use of paper order books. | December 2019 |
| | | | | |

| Priority | Assessment |
|----------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| High | <ul style="list-style-type: none"> • Key control absent or inadequate; • Serious breach of regulations; • Significantly impairs overall system of internal control; • No progress made on implementing control; • Requires urgent management attention. |
| Medium | <ul style="list-style-type: none"> • Element of control is missing or only partial in nature; • Weakness does not impair overall reliability of the system; • Recommendation considered important in contributing towards improvement in internal controls; • Management action required within a reasonable timescale. |

Note:

It should be recognised that where recommendations in the action plan are not implemented there may be an increased risk of a control failure. It should be noted however that it is the responsibility of management to determine the extent of the internal control system appropriate to their area of operation.