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Internal Audit Report 2016/2017

Finance

***Hinckley & Bosworth
Borough Council***

February 2017

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Distribution list

For action: Ilyas Bham (Accountancy Manager)

For information: Ashley Wilson (Section 151 officer)



Executive summary (1 of 3)

Report classification

Medium Risk
(15 points)



Trend

Remains consistent with prior year



Total number of findings

	Critical	High	Medium	Low	Advisory
Control design	-	-	-	-	-
Operating effectiveness	-	1	1	2	-
Total	-	1	1	2	-

Executive summary (2 of 3)



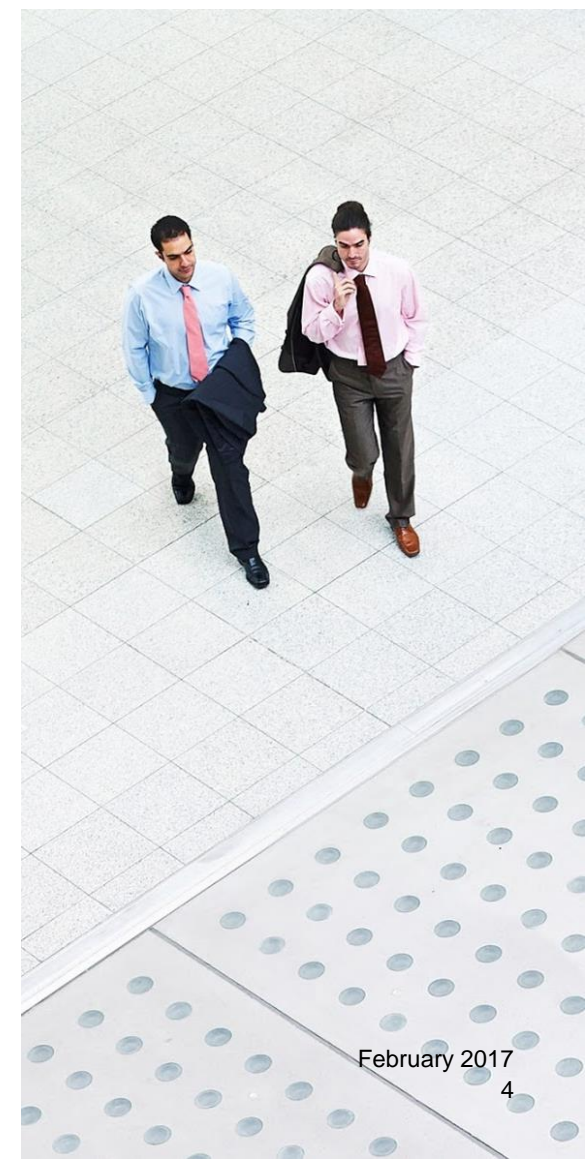
Headlines/summary of findings

This review sought to understand and evaluate key controls aimed at preventing or detecting fraud and preventing inappropriate cash payments from being processed by the Council. The key controls are considered to be system reconciliations, especially the bank reconciliations. Our prior year financial systems report identified an issue around the bank reconciliation and similar issues were noted as part of the external audit ISA 260 report; therefore we have focused our testing specifically on reconciliations.

The outcome is a report with a medium risk rating, as there were one high, one medium and two low risk findings:

1. **Reconciliations are not being robustly performed (high risk):** a number of issues were identified on four of the six reconciliations tested (bank, payroll, creditor and debtor accounts). These included reconciling items with no explanation, failure to address outstanding reconciling items and a lack of review of the payroll reconciliations;
2. **Audit trail for verifying changes to supplier details (low risk):** 1 of the 20 changes to supplier details reviewed identified that there was no audit trail to demonstrate the requested changes had been verified; and
3. **Audit trail of 'urgent' payments (low risk):** three of the eight urgent payments tested did not have any supporting documentation justifying why it was considered urgent. There is no procedure justifying when urgent payments can be made and they are agreed on a case by case basis with the Section 151 Officer or Accountancy Manager; and
4. **Prior year finding - Reconciliations are not performed in a timely manner (medium risk):** a number of instances were identified on three of the six reconciliations tested (bank, Council Tax and NNDR) where the reconciliations had not been performed in a timely manner at the beginning of the year.

On the whole the finance team have a strong control design system in place, issues simply occurred due to operating effectiveness.



Executive summary (2 of 3)

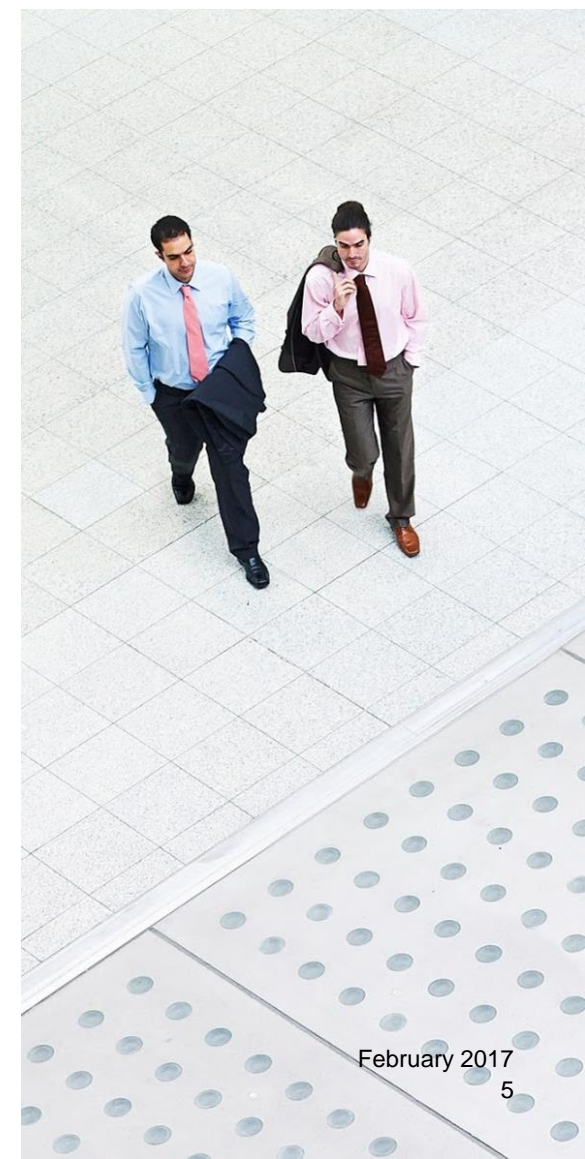


Headlines/summary of findings (continued)

It was pleasing to see a control implemented for the verification of supplier detail changes and our detailed testing for this control only picked up one low risk issue.

Management should continue to monitor the number of retrospective purchase orders and invoices without purchase orders. We would recommend that management take note of the action points in the following slides.

We would like to thank all staff involved for their help during the internal audit.



Current year findings (1 of 3)

Reconciliations are not being performed robustly

Operating effectiveness

1

Finding rating

Rating

High

Finding and root cause

We performed testing over reconciliations to confirm that they are performed accurately, timely and subject to independent review.

During our testing we found that where reconciliations had been performed, there was an indication that they had not been performed robustly. Issues identified included:

- Bank reconciliations had repeating reconciling items suggesting there are limited efforts to resolve reconciling items;
- Creditors reconciliation had an unreconciled difference of £37,000 for 12 weeks from June W3;
- Debtors reconciliation had an unreconciled difference of £1,700 for 12 weeks from June W3; and
- Payroll reconciliations did not have audit trail of who performed the task. Additionally, they were not being reviewed.

Implications

Discrepancies may exist resulting in inappropriate reporting and decision making.

Errors and frauds are not identified.

Action plan

- Ensure that members of staff are adequately trained to complete the reconciliations.
- Ensure that reconciling items are investigated.
- Ensure that a clear audit trail exists, showing the person who performed the task and the reviewer along with dates. We understand that since this issue has been raised this action has already been put in place.

Responsible person:

Ilyas Bham, Accountancy Manager

Target date:

ASAP

Current year findings (2 of 3)

Audit trail for verifying changes to supplier details

Operating effectiveness

2

Finding rating

Rating

Low

Finding and root cause

We performed detailed testing on a sample of 20 supplier detail changes to confirm that changes were being appropriately authorised and independently reviewed with a clear audit trail recorded on the system. The process requires that the Council will ask the supplier to complete a change form and then ring the supplier to independently verify the details, ensuring they use a number directly from the company's website. All these details are recorded on the system.

During our testing we found that in one instance there was no documentation to confirm that the change in bank details had been independently verified with a follow up phone call before a payment had been made.

Implications

Lack of oversight of supplier amendments could lead to inappropriate/fraudulent changes not being identified, and monetary loss to the Council.

Action plan

- Ensure members of staff are fully trained in the procedure.
- Ensure members of staff understand the importance of verifying the supplier details, in particularly the bank details.
- Ensure members of staff understand the importance of a clear audit trail.

Responsible person:

Ilyas Bham, Accountancy Manager

Target date:

February 2017

Current year findings (3 of 3)

Audit trail for 'urgent' payments

Operating effectiveness

3

Finding rating

Rating

Low

Finding and root cause

We performed detailed testing on a sample of 8 'urgent' payments to confirm that payments were being appropriately authorised and such payments are only being processed in truly urgent cases, with a clear documented audit trail.

During our testing we came across three instances, whilst there was documentation showing the payment was appropriately authorised, there was no clear audit trail to show why the payment was considered urgent. The Council does not have a formal procedure which defines instances which may be described as urgent, instead instances are agreed with the Section 151 Officer or Accountancy Manager.

Implications

'Urgent' payments being unnecessarily made which carry additional costs to the Council. Payments made through this process to avoid procurement/tendering procedures

Action plan

- Ensure management challenge any requests for an 'urgent' payment.
- Ensure a clear audit trail is recorded including evidence of what makes the payment 'urgent'.
- Consider introducing a policy which defines the circumstances by which an urgent payment can be made.

Responsible person:

Ilyas Bham, Accountancy Manager

Target date:

February 2017

General Observations (1 of 2)

Development Areas

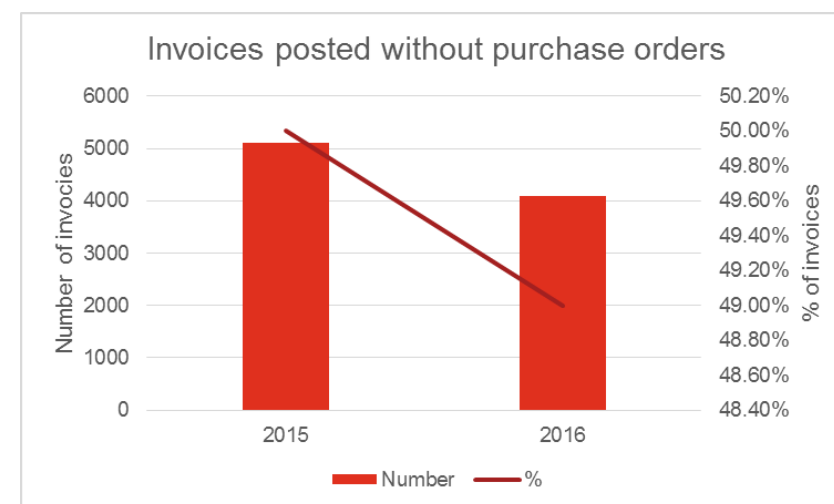
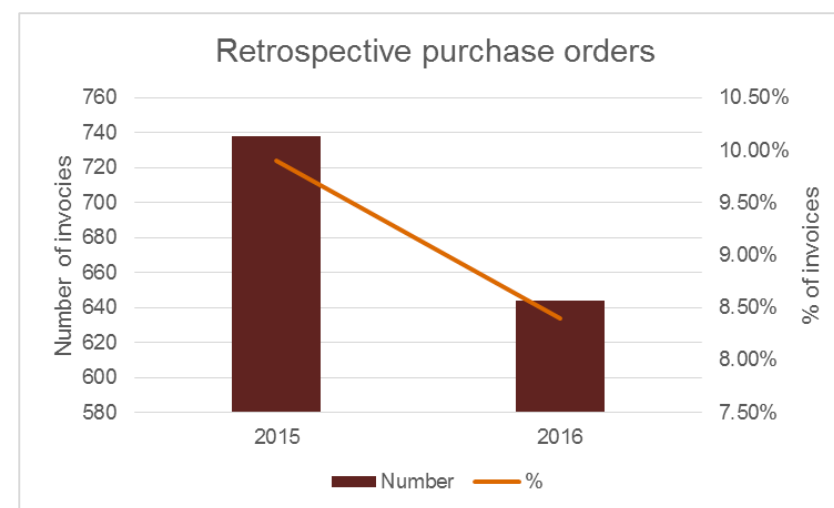
Retrospective purchase orders

We found that in our detailed testing 2 of the 25 items tested had a purchase order raised after the invoice date. We followed this up by analysing the whole population of invoices raised in the financial year to date and identified that 644 invoices, or 8.4% of the total number of invoices recorded, had purchase orders dated one or more days after the invoice date. This is an improvement on the prior year where 738 invoices, or 9.9% of the total number of invoices recorded, were identified.

Invoices paid without purchase orders

We also identified from our data analysis that 4,090 invoice lines (49% of the total recorded in the period) totalling £240,802,614 were paid but did not have a purchase order recorded against them. This is a marginal improvement on the prior year where 5114 invoice lines (50% of the total recorded in the period) were identified.

Management should continue to monitor these two areas as good practice will ensure inappropriate purchases are not made and value for money is obtained



General Observations (2 of 2)

Development Areas

Invoices processed long after invoice date

During our data analysis we noted that invoices are not processed in an efficient manner. It was discovered that a number of invoices were not processed until significantly after the invoice date:

Age		Number of invoices
1 month	0-29 Days	7232
2 month	30-59 Days	615
3 month	60-89 Days	128
3-6 months	90-179 Days	141
6-12 months	180-365 Days	43
Over 12 months	366+	44

Management should review the controls in place in order to identify the causes in the long delays.

Good Practice Noticed

- It was pleasing to see a control implemented for the verification of supplier detail changes showing that the team have actioned the point raised in the internal audit last year. The detailed testing around this control only picked up one issue which was considered low risk;
- Good controls exist around usernames and passwords ensuring that members of staff are regularly updating their passwords which helps to prevent unauthorised access and users have restricted access to the system depending on their roles;
- During our detailed testing it was clear that purchase orders are appropriately authorised along with invoices being appropriately authorised before payment; and
- The Council has a clear policy and procedure document in place which is available to all members of staff.

Prior year open findings

Reconciliations are not performed in a timely manner

Operating effectiveness

1

Finding rating

Rating

Medium

Original agreed action

Our report in 2015/16 highlighted that bank reconciliations were not being performed on a monthly basis. It was agreed that the bank reconciliations would be performed in accordance with the schedule developed and reviewed monthly by appropriate named officers.

Status update

We performed testing over reconciliations in the current year to confirm that they are performed accurately, on a monthly basis in line with the procedure and subject to independent review.

In the current financial year bank reconciliations had not been performed until October; this clearly indicates bank reconciliations are not performed on a monthly basis. We understand that the Accountancy Manager was aware of this situation which arose as a member of staff left the Council and there were capacity issues. By September the reconciliations were up to date. However as this issue was raised last year, there should be a process for critical reconciliations to take place in the event of absence, so we expected the Council to have trained a sufficient number of staff. Council Tax and NNDR April reconciliations had not been performed until July.

We understand that whilst there is a schedule in place with named officers and target dates, our testing indicates that this isn't being adhered to.

Action plan

- Ensure that the responsibility for performing and reviewing bank reconciliations going forward is clearly defined.
- Ensure a sufficient number of staff are trained in order to provide cover for absentees.
- Ensure that the reconciliation schedule is being adhered to.

Responsible person/title:

Ilyas Bham, Accountancy Manager

Target date:

ASAP



**Appendix A: Basis of our
classifications**

**Appendix B: Terms of
reference**

**Appendix C: Limitations
and responsibilities**

Appendices

Appendix A: Basis of our classification

Individual finding ratings

Critical

A finding that could have a:

- **Critical** impact on operational performance; or
- **Critical** monetary or financial statement impact; or
- **Critical** breach in laws and regulations that could result in material fines or consequences; or
- **Critical** impact on the reputation or brand of the organisation which could threaten its future viability.

High

A finding that could have a:

- **Significant** impact on operational performance; or
- **Significant** monetary or financial statement impact; or
- **Significant** breach in laws and regulations resulting in significant fines and consequences; or
- **Significant** impact on the reputation or brand of the organisation.

Medium

A finding that could have a:

- **Moderate** impact on operational performance; or
- **Moderate** monetary or financial statement impact; or
- **Moderate** breach in laws and regulations resulting in fines and consequences; or
- **Moderate** impact on the reputation or brand of the organisation.

Appendix A: Basis of our classifications

Individual finding ratings

Low

A finding that could have a:

- **Minor** impact on the organisation's operational performance; or
- **Minor** monetary or financial statement impact; or
- **Minor** breach in laws and regulations with limited consequences; or
- **Minor** impact on the reputation of the organisation.

Advisory

A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.

Report classifications

The report classification is determined by allocating points to each of the findings included in the report.

Findings rating	Points
Critical	40 points per finding
High	10 points per finding
Medium	3 points per finding
Low	1 point per finding

Report classification	Points
Low risk	6 points or less
Medium risk	7 – 15 points
High risk	16 – 39 points
Critical risk	40 points and over

Appendix B: Terms of reference



Background and audit objectives



This review is being undertaken as part of the 2016/2017 internal audit plan approved by the Audit Committee on the 27 June 2016.

Background and audit objectives

The 2015/16 internal audit report reviewed a number of key areas of the financial systems process including: general ledger, income and debtors, expenditure and creditors, bank, cash and treasury management, fixed assets, budgetary control and payroll. All reviews were low rated, with the exception of bank, cash and treasury management which was medium rated owing to the identification of one high risk recommendation relating to bank reconciliations. We understand that there have been no significant changes in the nature of controls in the key financial system areas therefore our review in 2016/17 is to be focused on the specific controls in place to address fraud and minimise the risk of cash fraudulently leaving the Council.

During 2015/16 there were two small scale frauds which resulted in the Council paying individuals based on fraudulent requests for payment. The Council has a defined process and controls in place to ensure that payments are made appropriately but where this process is not adhered to the Council is at risk of fraudulent transactions being processed. As a result of the identified frauds, the Council has reviewed its existing policies and controls and reiterated the importance of these controls to all staff members.

This review seeks to understand and evaluate key controls aimed at preventing or detecting fraud and preventing inappropriate cash payments from being processed by the Council. We will utilise our data analysis techniques to compare performance with the previous year and highlight any discrepancies in the data reviewed.



Audit scope and approach (1 of 2)



Scope

We will review the design and operating effectiveness of key controls in place relating to specific finance activities during the period from April 2016 to the date of audit fieldwork.

The sub-processes, and related control objectives included in this review are:

Sub-process	Objectives
Policy and procedures	<ul style="list-style-type: none"> The Council has a policy in place which outlines the key controls and processes in place There is a clear process for documenting and retaining information
Reconciliations	<ul style="list-style-type: none"> Bank reconciliations and reconciliations between the general ledger and sub-ledgers are performed on a timely basis, with reconciling items being appropriately addressed and independently reviewed
Changes to supplier details	<ul style="list-style-type: none"> Changes to supplier data are documented Changes to supplier details, including bank details, are controlled and monitored to ensure validity of suppliers
Expenditure process	<ul style="list-style-type: none"> Invoices are processed in a way which is consistent with the Council's policy There has been a reduction in the number of transactions processed without a purchase order compared with data analysis performed in 2015/16
Cash payments	<ul style="list-style-type: none"> Cash payments are processed in a way which is consistent with the Council's policy All payments are authorised before being made Urgent bank payments satisfy the requirements and are correctly authorised
Fraud controls	<ul style="list-style-type: none"> The Council has in place adequate controls to prevent and detect fraudulent transactions from being processed. This will specifically include consideration of exception reports.

Audit scope and approach (2 of 2)



Limitations of scope

The scope of our work will be limited to those areas outlined above. Our review will be performed in the context of the information provided to us. Where circumstances change the review outputs may no longer be applicable.

Audit approach

Our audit approach is as follows:

- Obtain an understanding of the process for the selected finance controls through discussions with key personnel, review of systems documentation and walkthrough tests where applicable;
- Identify the key risks of the selected finance controls;
- Evaluate the design of the controls in place to address the key risks; and
- Test the operating effectiveness of the key controls.



Internal audit team and key contacts



Internal audit team

Name	Role	Contact details
Richard Bacon	Head of Internal Audit	richard.f.bacon@uk.pwc.com
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Jodie Stead	Internal Audit Manager	jodie.a.stead@uk.pwc.com
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Will Haston	Internal Audit Team Member	william.p.haston@uk.pwc.com

Key contacts – Hinckley and Bosworth Borough Council

Name	Title
Ashley Wilson	Section 151 Officer, Interim Head of Finance
Ilyas Bham	Accountancy Manager



Timetable



Timetable

Fieldwork start	12/12/2016
Fieldwork completed	16/12/2016
Draft report to client	13/01/2017
Response from client	20/01/2017
Final report to client	27/01/2017

Agreed timescales are subject to the following assumptions:

- All relevant documentation, including source data, reports and procedures, will be made available to us promptly on request.
- Staff and management will make reasonable time available for interviews and will respond promptly to follow-up questions or requests for documentation.

Please note that if Hinckley and Bosworth Borough Council requests the audit timing to be changed at short notice and the audit staff cannot be deployed to other client work, Hinckley and Bosworth Borough Council may still be charged for all/some of this time. PwC will make every effort to redeploy audit staff in such circumstances.



Appendix C: Limitations and responsibilities

Limitations inherent to the internal auditor's work

We have undertaken this review subject to the limitations outlined below:

Internal control

Internal control systems, no matter how well designed and operated, are affected by inherent limitations. These include the possibility of poor judgment in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls and the occurrence of unforeseeable circumstances.

Future periods

Our assessment of controls is for the period specified only. Historic evaluation of effectiveness is not relevant to future periods due to the risk that:

- The design of controls may become inadequate because of changes in operating environment, law, regulation or other changes; or
- The degree of compliance with policies and procedures may deteriorate.

Responsibilities of management and internal auditors

It is management's responsibility to develop and maintain sound systems of risk management, internal control and governance and for the prevention and detection of irregularities and fraud. Internal audit work should not be seen as a substitute for management's responsibilities for the design and operation of these systems.

We endeavour to plan our work so that we have a reasonable expectation of detecting significant control weaknesses and, if detected, we carry out additional work directed towards identification of consequent fraud or other irregularities. However, internal audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected.

Accordingly, our examinations as internal auditors should not be relied upon solely to disclose fraud, defalcations or other irregularities which may exist.

This document has been prepared only for Hinckley & Bosworth Borough Council and solely for the purpose and on the terms agreed with Hinckley & Bosworth Borough Council in our agreement dated 10 May 2016. We accept no liability (including for negligence) to anyone else in connection with this document, and it may not be provided to anyone else.

Internal audit work was performed in accordance with PwC's Internal Audit methodology which is aligned to Public Sector Internal Audit Standards. As a result, our work and deliverables are not designed or intended to comply with the International Auditing and Assurance Standards Board (IAASB), International Framework for Assurance Engagements (IFAE) and International Standard on Assurance Engagements (ISAE) 3000.

In the event that, pursuant to a request which Hinckley & Bosworth Borough Council has received under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004 (as the same may be amended or re-enacted from time to time) or any subordinate legislation made thereunder (collectively, the "Legislation"), Hinckley & Bosworth Borough Council is required to disclose any information contained in this document, it will notify PwC promptly and will consult with PwC prior to disclosing such document. Hinckley & Bosworth Borough Council agrees to pay due regard to any representations which PwC may make in connection with such disclosure and to apply any relevant exemptions which may exist under the Legislation to such [report]. If, following consultation with PwC, Hinckley & Bosworth Borough Council discloses any this document or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.

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