


# *Internal Audit Report 2015/2016*

## Financial Systems



April 2016

Hinckley and Bosworth  
Borough Council

# Contents

## **1. Executive summary**

## **2. Detailed current year findings**





Appendix 1. Data analysis of journals	14
Appendix 2. Basis of our classifications	17
Appendix 2. Terms of Reference	19
Appendix 3. Limitations and responsibilities	xxii




**2** Internal audit work was performed in accordance with 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.

### **Distribution List**

For action	Ashley Wilson (Interim Head of Finance)
	Ilyas Bham (Accountancy Manager)
	Beverley Bee (Payroll Manager)
For information	Sanjiv Kohli (Deputy Chief Executive, Corporate Direction)

# ***1. Executive summary***

<i><b>Financial System</b></i>	<i><b>Report classification</b></i>	<i><b>Total number of findings</b></i>					
			Critical	High	Medium	Low	Advisory
General ledger	 Low risk (3 points)						
		Control design	-	-	-	-	-
		Operating effectiveness	-	-	1	-	-
		<b>Total</b>	-	-	<b>1</b>	-	-
Income and debtors	 Low risk (1 point)						
		Control design	-	-	-	1	-
		Operating effectiveness	-	-	-	-	-
		<b>Total</b>	-	-	-	<b>1</b>	-
Expenditure and creditors	 Low risk (4 points)						
		Control design	-	-	1	-	-
		Operating effectiveness	-	-	-	1	-
		<b>Total</b>	-	-	<b>1</b>	<b>1</b>	-
Bank, cash and treasury management	 Medium risk (10 points)						
		Control design	-	-	-	-	-
		Operating effectiveness	-	1	-	-	-
		<b>Total</b>	-	<b>1</b>	-	-	-

		Critical	High	Medium	Low	Advisory	
Fixed assets	 No issues identified						
		Control design	-	-	-	-	-
		Operating effectiveness	-	-	-	-	-
		<b>Total</b>	-	-	-	-	-
Budgetary control	 No issues identified						
		Control design	-	-	-	-	-
		Operating effectiveness	-	-	-	-	-
		<b>Total</b>	-	-	-	-	-
Payroll	 Low risk (1 point)						
		Control design	-	-	-	-	1
		Operating effectiveness	-	-	-	1	1
		<b>Total</b>	-	-	-	1	2

## *Headlines / summary of findings:*

### *Introduction*

At the end of the financial year 2014/15 Hinckley and Bosworth Borough Council held substantial usable reserves of £22,924k. The most recent outturn report shows £11,868,892 being spent on services in 2015/16 with a net amount of £33,365 being transferred from earmarked reserves and £188,634 being transferred to General Fund balances. A net underspend of £29,178 is forecast to year end.

This review considered controls and processes in place across the following key financial systems:

- General ledger;
- Income and debtors;
- Expenditure and creditors;
- Bank, cash and treasury management;
- Fixed assets;
- Budgetary control; and
- Payroll.

In addition to agreeing which controls we would test with management, we consulted the Council's external auditors (EY) to ensure that our testing met external audit requirements. We tested the key controls set out in the Terms of Reference included at Appendix 2. Our findings and risk ratings have been split in to each financial system area.

### *General ledger*

We have performed detailed analysis on the entire data set of journals posted in the period from 1<sup>st</sup> April 2015 to 30<sup>th</sup> November 2015 and as part of this confirmed that there is adequate separation of duties when creating and approving journals. We have presented some of our analysis in Appendix 1.

Sub ledgers should be regularly reconciled to the general ledger to ensure that the main accounting records are accurate. Our testing of reconciliations between sub ledgers and the general ledger found that reconciliations are performed regularly but in some cases there is no independent oversight of the accuracy and completion of the reconciliations. We recommend that a second officer should review reconciliations and their completion should be monitored.

### *Income and debtors*

Our testing of the processes surrounding aged debtor analysis identified that some improvements could be made. There is currently significant manual intervention in aged debt monitoring and the functionality of the finance package could be better utilised in this area.

Responsibility for collecting debt and initiating write offs lies with the individual service departments. There is a large value of debt (approx. £1m) dating from 2013 and earlier and consideration should be given to undertaking a one-off exercise to review and write off this debt where necessary.

### *Expenditure and creditors*

The current procedure for amending supplier details, including bank details, is that officers are informed of amendments required or changes are identified on supplier invoices, then the validity of these amendments is confirmed directly with the supplier through a telephone call or email before processing. Regular monitoring and review of amendments by an independent officer can help identify any unusual changes requiring investigation. Instances of fraud against public sector bodies arising from changes to supplier data have increased in recent years therefore we recommend this additional control is put in place.

We performed detailed testing on a sample of 25 expenditure items. We found 6 purchase orders were raised and approved on the same date as, or at a later date than, the invoice date. Analysis of the whole population of invoices recorded in the financial year to date identified that 9.9% of invoices had purchase orders dated one or more days after the invoice date. Furthermore, 49% of invoice lines were paid without a purchase order recorded against them (though approval at invoice level was obtained).

The practise of raising retrospective purchase orders should be discouraged as it allows officers to bypass approved suppliers and quotation requirements and we recommend that officers should be reminded of this. The Council should also consider introducing a process whereby if an invoice is received without a purchase order it is returned to the supplier.

### *Bank, cash and treasury management*

As part of the month end process bank reconciliations should be performed. We found that reconciliations had not been performed since May 2015 due to an issue with staff capacity. There is now a timetable in place for the outstanding reconciliations to be performed and the Council should ensure that responsibility for performing and reviewing bank reconciliations going forward is clearly defined.

### *Fixed assets*

The fixed asset register is updated at year end so we were unable to fully test this at the time of our audit work. We have considered the processes in place to ensure that additions and disposals are correctly identified and approved and identified no issues. We have reviewed the current fixed asset register and confirmed that depreciation charges are in line with the Council's policy.

### *Budgetary control*

No issues were identified.

### *Payroll*

The Council's expenses policy requires claims to be submitted within two months of expenses being incurred. We tested 25 expense claims made and found that one related to expenditure backdated over the previous two years. This was approved by exception because the claimant had not been aware that they were eligible to claim expenses. We propose that the Council should ensure that the expenses policy is communicated effectively to all officers.

We also found some minor issues with recording of employee documentation and recommend that payroll officers are reminded of the correct procedures to follow.

## 2. Detailed current year findings

### 1. Bank reconciliations are not regularly performed – operating effectiveness

#### Finding

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

In the current financial year bank reconciliations have only been performed for April and May. Whilst we were able to confirm that the reconciliations completed were performed correctly, bank reconciliations are clearly not performed on a monthly basis. We understand that this is due to a member of staff leaving the Council in June 2015 and ensuing capacity issues.

Since our work was completed a schedule has been put in place with named officers and target dates to ensure that bank reconciliations are up to date by the end of the financial year.

#### Implications

Discrepancies may exist between the financial systems and the bank account, resulting in inappropriate reporting and decision making.

Errors and frauds are not identified on a timely basis.

#### Action plan

#### Finding rating

  
High risk

#### Agreed action

- The outstanding bank reconciliations for 2015/16 will be performed and reviewed according to the new schedule.
- From 2016/17 bank reconciliations will be performed and reviewed monthly by appropriate named officers.

#### Responsible person / title

Ilyas Bham (Accountancy Manager)

#### Target date:

1<sup>st</sup> May 2016

#### Reference number:

FS01



## 2. Reconciliations between sub ledgers and the general ledger are not reviewed – operating effectiveness

### Finding

As part of the month end process a number of control accounts are reconciled to the general ledger. We selected two reconciliations to test for the following sub ledgers:

- payroll
- council tax/NNDR
- creditors control
- debtors control

Reconciliations were performed on a timely basis for all sub ledgers. Of the two reconciliations we selected to test for council tax/NNDR and payroll there was no evidence of review by a separate officer.

We understand that a 'tick-sheet' was previously used to monitor the completion and review of reconciliations, however this is no longer utilised.

### Implications

Errors made in reconciliations are not identified.

### Action plan

#### Finding rating



Medium risk

#### Agreed action

- Reconciliations will be reviewed and signed off as accurate and complete by an appropriate, independent officer.
- A schedule for performing and reviewing reconciliations will be created so responsibilities are clear. Adherence to the schedule will be monitored by a senior officer.

#### Responsible person / title

Ilyas Bham (Accountancy Manager)

#### Target date:

1<sup>st</sup> May 2016

#### Reference number:

FS02

### 3. Changes to supplier details are not monitored effectively – control design

#### *Finding*

When a supplier contacts the Council to change their contact or bank details, the officer receiving the request places a follow-up call or email to the supplier to ensure that the request is genuine. Evidence is retained to support this check and the supplier's details are updated on the system.

We were unable to obtain a complete listing of changes made to supplier details to fully test whether appropriate checks had been made prior to changes being processed. The system holds records of amendments at individual supplier level, but we were told that it is not currently feasible to run a report detailing all changes made. We tested one supplier amendment identified from a note on an invoice and found that the correct procedure was followed, but it is not possible for us to conclude from this that the process is operating effectively overall due to the lack of documentation available.

As a complete list of amendments is not available, there is no oversight by management of changes to supplier details. Supplier amendments should be monitored by an officer independent of those making the changes.

#### *Implications*

There is no clear audit trail for amending supplier details.

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

#### *Action plan*

##### *Finding rating*

  
Medium risk

##### *Agreed action*

- The Council has engaged with the software supplier generate a report detailing changes to supplier details. It will be reviewed and approved by the team leader on a weekly basis.
- This report will be reviewed for reasonableness by an independent officer on a monthly basis.

##### *Responsible person / title*

Ilyas Bham (Accountancy Manager)

##### *Target date:*

1<sup>st</sup> May 2016

##### *Reference number:*

FS03

#### 4. Aged debt reporting – control design

##### *Finding*

We have reviewed the processes in place for monitoring and writing off aged debts. Monitoring aged debt involves running a report from the system and manually typing information from this into an Excel spreadsheet used to analyse aged debts. This is labour intensive and, while part of the process is required to enable reporting in the style required by senior officers, the functionality of the financial package could be better utilised to increase automation.

Responsibility for pursuing outstanding debt and identifying debts for write off is devolved to service departments. There is a large value of debt (approx. £1m) dating from 2013 and earlier, and consideration should be given to undertaking a one-off exercise to review and write off this debt where necessary.

##### *Implications*

Complex manual process may lead to errors being made in the aged debt analysis, and resource could be more effectively utilised elsewhere.

The large value of uncollectable debts causes an administrative burden as they are analysed each month, and there is a risk that Receivables could be overstated in the financial statements.

##### *Action plan*

##### *Finding rating*

  
Low risk

##### *Agreed action*

- Engage with the IT department or the software provider to train finance staff on how to run aged debt reports from the system in the format which is required.
- Consider undertaking a one-off exercise to review aged debt and write off where necessary.

##### *Responsible person / title*

Ilyas Bham (Accountancy Manager)

##### *Target date:*

30<sup>th</sup> June 2016

##### *Reference number [optional]:*

FS04

## 5. Use of purchase orders – operating effectiveness

### Finding

#### **Retrospective purchase orders**

We performed detailed testing on a sample of 25 expenditure items. We found that for 6 items tested the purchase order was raised on or 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 738 invoices, or 9.9% of the total number of invoices recorded, had purchase orders dated one or more days after the invoice date.

The Council's Financial Procedure Rules require that orders are placed through the official ordering process unless urgent. We understand that retrospective purchase orders are discouraged and a list of persistent offenders at service level is reported quarterly to the Corporate Operations Board.

#### **Invoices paid without purchase orders**

We also identified from our data analysis that 5008 invoice lines (49% of the total recorded in the period) totalling £234,085k were paid but did not have a purchase order recorded against them. Of these, £166,000k related to investments and £35,000k to precepts.

### Implications

Inappropriate purchases may be made.

Value for money may not be obtained.

### Action plan

#### Finding rating

  
Low risk

#### Agreed action

- Communicate to officers that purchase orders should be used for all purchases (allowing for identified exceptions) to ensure that procurement controls are not bypassed.
- Consider returning invoices which do not contain purchase order details to suppliers, in order for a purchase order to be raised prior to payment.

#### Responsible person / title

Ilyas Bham (Accountancy Manager)

#### Target date:

31<sup>st</sup> March 2016

#### Reference number [optional]:

FS05

## 6. Expense claims – operating effectiveness

### *Finding*

The Council's expense policy states that all expenses should be claimed within a period of two months. We tested a sample of 25 expense claims to ensure the correct process had been followed.

One of the items tested was a claim for mileage covering the previous two years, amounting to £1,468. A working paper was provided which fully supported the total claim amount. The claim was made late due to the employee being unaware that they could submit expense claims.

### *Implications*

When claims are not timely they are more likely to be inaccurate and difficult to verify.

### *Action plan*

#### *Finding rating*



Low risk

#### *Agreed action*

The Council will ensure that the expenses policy is communicated effectively to all officers.

#### *Responsible person / title*

Beverley Bee (Payroll Manager)

#### *Target date:*

31<sup>st</sup> March 2016

#### *Reference number [optional]:*

FS06

## 7. Mileage expenses – advisory

### *Finding*

Our testing of travel expenses identified that postcodes are not recorded in claims. This makes it difficult for the Council to verify the accuracy of mileage claims.

### *Recommendation*

Consider amending the expenses policy to require that employees should include relevant postcodes when making mileage expense claims.

## 8. Payroll incomplete documentation – advisory

### *Finding*

All documentation for Starters and Leavers is stored on the payroll system Anite. We tested a sample of 20 starters and 20 leavers to ensure that the Council is operating in accordance with its procedures. We noted that employee documentation was missing from Anite for 2 starters. We viewed the hardcopy documents but these had not been scanned onto the system

We also identified that no leavers form was completed for one of the leavers tested. The employee in question had only worked for one week and was input and removed on the payroll system on the same day.

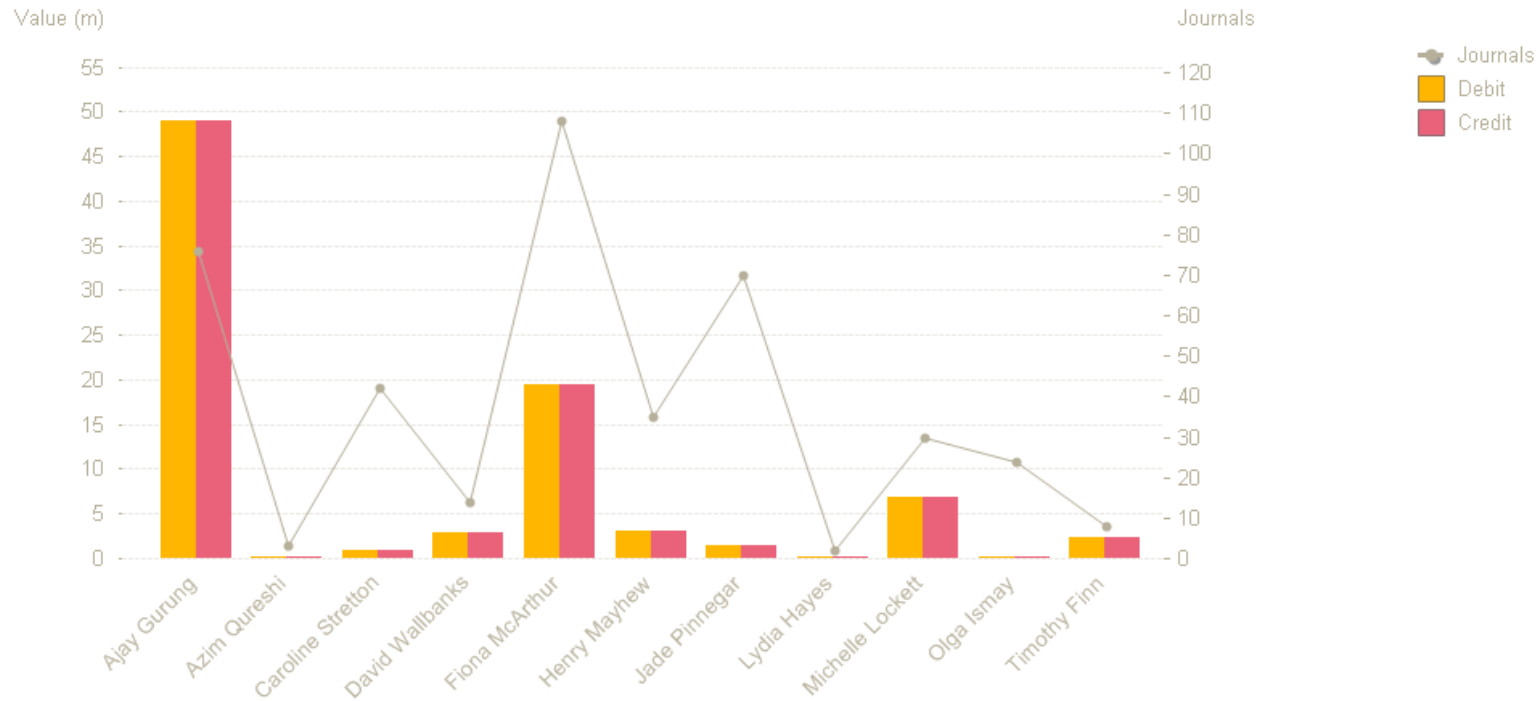
### *Recommendation*

All documentation should be scanned, uploaded and indexed onto Anite on a timely basis.

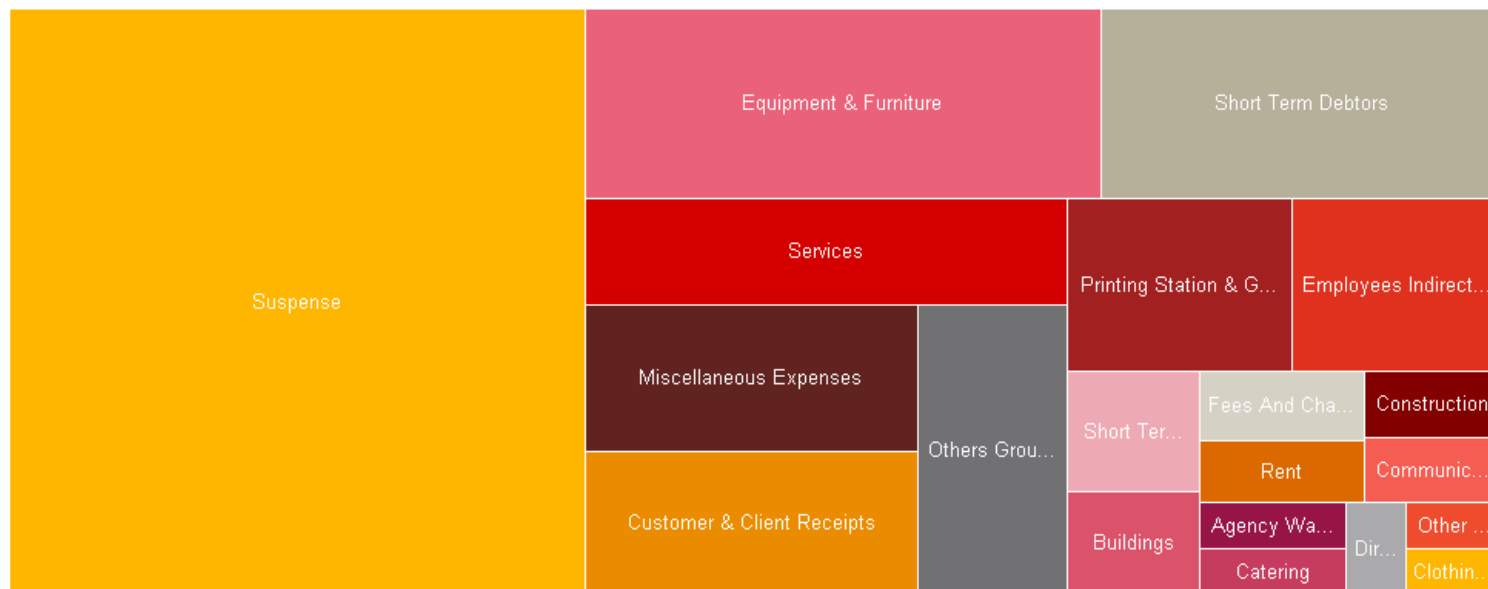
The process for leavers should be followed and appropriate documents should be completed regardless of length of service.

# Appendix 1. Data analysis of journals

## Analysis of journals raised by individual officer



## Analysis of reversing journals



The chart shows relative amounts of reversing journals posted based on account type.

1.6% of journal lines raised in the period tested were subject to reversal or were raised to reverse previous journals.

The majority of the journals involved the suspense account Z9998.

By value, the biggest lines of account were Cash and Cash Equivalents at £4,313k and Temporary Borrowings at £3,737k.



### *Analysis of journals posted at the weekend*

Our analysis of journals posted between 1<sup>st</sup> April 2015 and the date of the audit revealed that no journals were posted on Saturdays or Sundays.

## Appendix 2. Basis of our classifications





### Individual finding ratings

<i>Finding rating</i>	<i>Assessment rationale</i>
<b>Critical</b>	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>• <b>Critical</b> impact on operational performance; or</li> <li>• <b>Critical</b> monetary or financial statement impact; or</li> <li>• <b>Critical</b> breach in laws and regulations that could result in material fines or consequences; or</li> <li>• <b>Critical</b> impact on the reputation or brand of the organisation which could threaten its future viability.</li> </ul>
<b>High</b>	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>• <b>Significant</b> impact on operational performance; or</li> <li>• <b>Significant</b> monetary or financial statement impact; or</li> <li>• <b>Significant</b> breach in laws and regulations resulting in significant fines and consequences; or</li> <li>• <b>Significant</b> impact on the reputation or brand of the organisation.</li> </ul>
<b>Medium</b>	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>• <b>Moderate</b> impact on operational performance; or</li> <li>• <b>Moderate</b> monetary or financial statement impact; or</li> <li>• <b>Moderate</b> breach in laws and regulations resulting in fines and consequences; or</li> <li>• <b>Moderate</b> impact on the reputation or brand of the organisation.</li> </ul>
<b>Low</b>	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>• <b>Minor</b> impact on the organisation's operational performance; or</li> <li>• <b>Minor</b> monetary or financial statement impact; or</li> <li>• <b>Minor</b> breach in laws and regulations with limited consequences; or</li> <li>• <b>Minor</b> impact on the reputation of the organisation.</li> </ul>
<b>Advisory</b>	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

<i>Findings rating</i>	<i>Points</i>
<b>Critical</b>	40 points per finding
<b>High</b>	10 points per finding
<b>Medium</b>	3 points per finding
<b>Low</b>	1 point per finding

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

# Appendix 2. Terms of Reference

**To:** Ashley Wilson (Interim Head of Finance), Ilyas Bham, Accountancy Manager  
**From:** Kate Mulhearn, Internal Audit Senior Manager

This review is being undertaken as part of the 2015/16 internal audit plan approved in draft by the Finance, Audit and Performance Committee on 13th April 2015.

## Background

The Financial Systems review is being undertaken as part of risk based assurance work included in the 2015/16 Internal Audit plan.

This review will cover the following systems:

- General ledger
- Income & debtors
- Expenditure & creditors
- Bank, cash and treasury management
- Fixed assets
- Budgetary control
- Payroll

## Scope

We will review the control design and operating effectiveness of aspects of the key financial systems during the period 1 April 2015 to the audit date. The sub-processes and related control objectives included in this review are:

Sub-process	Objectives
General ledger	<ul style="list-style-type: none"><li>• Journals are posted and authorised by appropriate officers.</li><li>• Journal listings are complete and reconcile to the list of deleted journals held by finance.</li><li>• Reconciliations between the general ledger and sub ledgers are performed timely and are appropriately reviewed.</li></ul>
Income & debtors	<ul style="list-style-type: none"><li>• Income received is allocated to the correct invoice.</li><li>• Unallocated cash is cleared regularly.</li><li>• Debtors invoices are raised in all appropriate circumstances.</li><li>• Debtor ageing is monitored and timely recovery action taken.</li></ul>
Expenditure & creditors	<ul style="list-style-type: none"><li>• Changes to supplier bank details are controlled and monitored to ensure validity of suppliers.</li><li>• Payments are only made for goods which have been authorised and received.</li><li>• HSBC net payments satisfy the requirement of being urgent payments, and are correctly authorised.</li></ul>
Bank, cash and treasury management	<ul style="list-style-type: none"><li>• Bank reconciliations are accurate, timely and independently reviewed.</li><li>• Cash flow forecasting is performed on a timely basis and is based on reasonable assumptions.</li><li>• Investments and borrowings are in compliance with the Council's Treasury Management and authorisation policies.</li></ul>

<b>Sub-process</b>	<b>Objectives</b>
Payroll	<ul style="list-style-type: none"> <li>• Valid new starters are added to the payroll system accurately and on a timely basis.</li> <li>• Leavers are removed from the payroll system on a timely basis.</li> <li>• Expense claims are supported by relevant documentation and approved in line with Council procedures.</li> </ul>
Fixed assets	<ul style="list-style-type: none"> <li>• The recording of additions and disposals of fixed assets is complete and accurate.</li> <li>• Fixed asset additions are approved and are in accordance with the Council's strategy.</li> <li>• Depreciation charges are complete, accurate and in accordance with the Council's depreciation policy.</li> </ul>
Budgetary control	<ul style="list-style-type: none"> <li>• Budget monitoring is performed on a regular basis and action taken on variances.</li> </ul>

### *Limitations of scope*

The scope of our work will be limited to those areas outlined above and is dependent on sufficient data being available to us. 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 key financial systems through discussions with key personnel, review of systems documentation and walkthrough tests;
- Identify the key risks relating to financial systems;
- Evaluate the design of the controls in place to address the key risks; and
- Test the operating effectiveness of the key controls.
- We will also use data audit procedures to analyse data contained in the key financial systems, to support controls testing. We have identified specific tests through discussion with the Council based on anticipated data that can be extracted from the relevant systems.



# ***Appendix 3. Limitations and responsibilities***

## ***Limitations inherent to the internal auditor's work***

We have undertaken the review of Financial Systems, 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; 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 shall 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.