

EAST RENFREWSHIRE COUNCIL
AUDIT AND SCRUTINY COMMITTEE

17 August 2017

Report by Clerk

LOCAL EXTERNAL AUDIT REPORT
INTERIM AUDIT REPORT 2016/17

PURPOSE OF REPORT

1. To submit the *Interim Audit Report 2016/17* prepared the Council's External Auditor to the Committee for consideration.

RECOMMENDATION

2. It is recommended that the Committee considers the report.

BACKGROUND

3. A copy of the *Interim Audit Report 2016/17* prepared by the Council's External Auditor which was published this month has already been circulated to all Audit and Scrutiny Committee Members. Pending the re-establishment by the Committee of specialisation arrangements for dealing with such reports, the Members who are leading the review of this particular report are Councillor Miller and Councillor Grant. The attached report supersedes one that was submitted to the Committee annually in previous years under the title of *Key Controls*.

RECOMMENDATION

4. It is recommended that the Committee considers the report.

Local Government Access to Information Act 1985

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Background Paper:-

1. Local External Audit Report - Interim Audit Report 2016/17

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East Renfrewshire Council

Interim Audit Report 2016/17

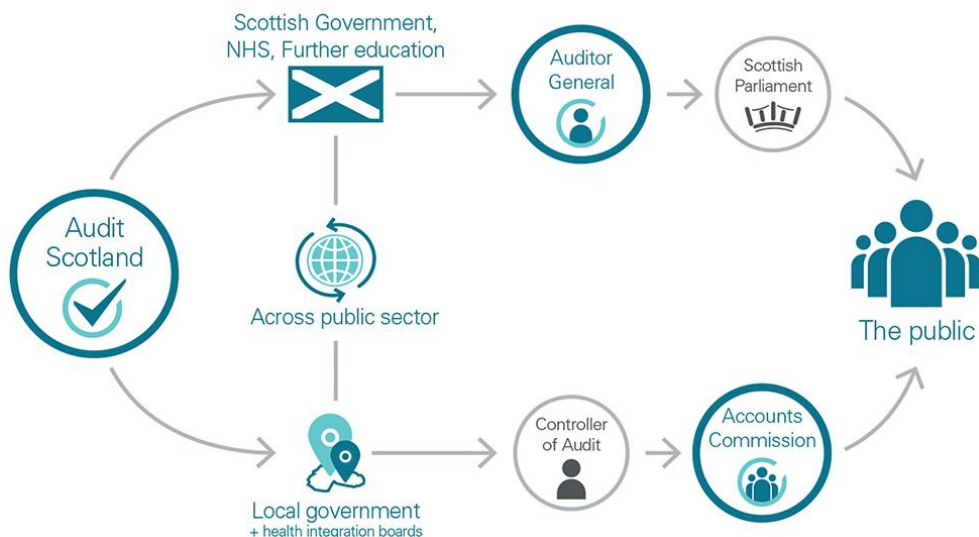


Prepared for East Renfrewshire Council
August 2017

Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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Audit findings

Introduction

1. This report contains a summary of the key issues identified during the interim audit work carried out at East Renfrewshire Council. This work included testing of key controls within financial systems to gain assurance over the processes and systems used in preparing the financial statements. We will use the results of this testing to determine our approach during the 2016/17 financial statements audit.
2. Our responsibilities under the Code of Audit Practice require us to assess the system of internal control put in place by management. We seek to gain assurance that the audited body:
 - has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements
 - has systems of internal control which provide an adequate means of preventing and detecting error, fraud or corruption
 - complies with established policies, procedures, laws and regulations.

Conclusion

3. A significant failure in key controls took place within the Creditors section in March 2017. The council were subject to a fraudulent request to change a supplier's bank account details. This request was made at the time when the council wrote to all suppliers to request invoices be sent to the creditors team and to update suppliers' bank details. This change was made by the council with no checks undertaken by officers, against Council procedures. Two subsequent payments totalling £2.3 m were made to the fraudulent bank account. Procedures employed by the council's bank stopped these payments and all the monies were refunded to the council.
4. This control failure was investigated by the council's Internal Auditors and they have reported that between December 2016 and March 2017, no confirmation checks were undertaken on 130 changes to suppliers' bank account details and that council procedures were not followed. These 130 cases were of varying categories of risk, ranging from the highest risk notifications of changes to bank details by suppliers (potentially fraudulent) to the lowest risk notifications of changes received direct from the Council's bank via Advice of Wrong Account for Automated Credits Service (AWACS) notification. The council are currently retrospectively checking all changes made during this period and have strengthened the previous procedures for changing supplier details. This has been a significant weakness in the council's control environment. Therefore, as part of the 2016/17 financial statements audit, we will also carry out additional checks on the changes to suppliers' bank details and establish whether retrospective checks are adequately completed.
5. Our review of creditors found that there was no evidence to support the completion of checks undertaken to reduce the risk of duplicate/erroneous payments being made. This had previously been reported to the Audit and Scrutiny by Internal Audit as being a weakness in 2016/17. We are advised that management action had been taken at the time to upgrade the system (AP Forensics) which would flag potential duplicate/erroneous payments prior to any

payment run, but it has become clear that there were issues with implementation of this upgrade meaning that potential duplicates/erroneous payments were not flagged automatically.

6. Further testing undertaken by both internal audit and external audit showed that the council were not running the AP Forensics exception reports of possible duplicate payment as required by council procedures. Instead manual based checks were being carried out. Our testing of a sample of 20 potential duplicate/erroneous payments to creditors found that 12 overpayments totalling £118,775 (gross of VAT) to creditors had been made. The council has now instructed a review of all potential duplicate payments in 2015/16 and 2016/17. We will review the findings of this additional work and the impact on the 2016/17 financial statements. It is essential that potential errors are fully documented and an audit trail is maintained.

7. On the basis of our review and testing of the financial systems we are able to conclude that, with the exceptions noted above, the council's main internal controls can be relied on to support the preparation of the 2016/17 financial statements.

8. We did identify several other areas where existing controls should be improved. These are summarised in [Exhibit 1](#) overleaf.

Work summary

9. Our 2016/17 testing covered key controls in a number of main financial systems including; main accounting, cash and bank, payroll and budget monitoring and control.

10. In accordance with *ISA 330: the auditor's response to assessed risk*, our audit judgements are based on current year testing of controls and where appropriate prior year results. Our risk based audit approach allows us to take a three-year cyclical approach to controls testing. This approach enables us to place reliance on previous years' audit work where controls remain unchanged and no significant weaknesses had been identified. Also, where possible we place reliance on the work of internal audit to avoid duplication of effort.

11. In our Annual Audit Plan, we reported our intention to rely on the work of Internal Audit in a number of areas. We have now completed our review of Internal Audit and their work and are able to place reliance as follows:

Key System	External audit coverage	Reliance on internal audit work
Debtors	✓	✓
Payroll - all payruns	✓	✓
Housing - Rent accounting	✓	✓
Finance ledger	✓	✓
Creditor payments	✓	✓

12. The contents of this report have been discussed with relevant officers to confirm factual accuracy. The co-operation and assistance we received during the course of our audit is gratefully acknowledged.

Follow up of the 2015/16 interim work

13. A review of internal controls and a review of the Care Finance system were carried out as part of the 2015/16 audit. We have followed up the actions agreed from these reviews and found that all of the recommendations have been completed as planned.

14. An action relating to the segregation of duties within HR and payroll remains outstanding. An update on this with revised management responses and timescales, have been included in [Exhibit 1](#).

Risks identified

15. The key control and wider dimension risks identified during the interim audit are detailed in [Exhibit 1](#). These findings will inform our approach to the financial statements audit where relevant.

16. Any weaknesses identified represent those that have come to our attention during the course of normal audit work and therefore are not necessarily all the weaknesses that may exist. It is the responsibility of management to decide on the extent of the internal control system appropriate to East Renfrewshire Council.

Exhibit 1

Key findings and action plan 2016/17

Issue identified	Management response	Responsible officer and target date
Audit findings		
<p>Creditors: Supplier details changes</p> <p>Changes to the bank details to a council supplier were made. No checks were made to confirm the validity of these changes. This was contrary to council procedures.</p> <p>There is risk of payments being made on the basis of fraudulent bank change requests.</p>	<p>Written procedures were in place to instruct staff to double check and verify any new banking information. Regrettably these procedures were not followed consistently at the time of an attempted fraud in March 2017.</p> <p>The attempted fraud was notified to Internal Audit immediately.</p> <p>This was a result of a temporary lapse in management controls, against council procedure, as a result of human error and misinterpretation of the process during a period of significant change.</p> <p>Validation checks have been commenced on all 130 cases where bank details were changed during the period of weakened controls. . Payments to these suppliers have been suspended until appropriate confirmation is received. Most are now complete and validated and there have been no further cases of fraud identified or financial losses to the Council.</p> <p>Control procedures were immediately put back in place when this attempted fraud was notified in March 2017.</p> <p>Internal Audit are currently (July 2017)</p>	<p>Louise Pringle</p> <p>Head of Business Change and Revenues</p> <p>September 2017</p>

Issue identified	Management response	Responsible officer and target date
	<p>carrying out testing to verify robustness of checking procedures in the service and a detailed investigation into the circumstances of this event is being carried out with Audit support.</p> <p>The fraud attempt has also been reported to Police Scotland. Internal Audit have confirmed that the letter received by the Council was almost identical to a number of letters received by public sector organisations throughout the UK around the same time. Internal Audit have also confirmed that, in their view, the attempted fraud was not internal to the Council or to the company whose details were forged.</p>	
<p>Payroll: Short term Supply Teacher</p> <p>Our testing highlighted that the standing data table contained within the council's payroll system in relation to short term supply teachers had not been updated since 2014. As such, annual pay increments due to these members of staff had not been implemented for a period of 3 years.</p> <p>The impact of this is that all short term supply teachers employed by the council have been underpaid. The council estimate the value of this underpayment to be £1,800.</p>	<p>The short term supply rate, for the first two days in a supply contract, was not changed fully in line with the pay award for April 15 and April 16 and therefore short term supply employees were underpaid for these 2 days. The underpayment was calculated at £1,791 in total and the arrears due to employees were paid on 25 May 2017.</p> <p>Updated procedures are now in place for Pay awards with an additional check implemented to ensure the short term supply rate is updated.</p>	<p>Sharon Beattie Head of HR, Customer and communications Complete</p>
<p>Main Accounting System: System access controls</p> <p>Annual confirmation checks are completed by officers to review and validate the access held by staff to the main financial ledger and the council tax system. Service departments are required to return the completed validation forms to central finance. However, these annual checks are not always fully completed and returned by departments.</p> <p>Unauthorised access to council systems increases the risk of fraudulent transactions.</p>	<p>Agreed. Regular reminders will be sent to ensure that the annual confirmation checks are completed by key staff. If confirmation responses are not provided this will be escalated to the Head of Accountancy.</p>	<p>Paul Parsons Principal Accountant (Capital) March 2018</p>
<p>Main Accounting System: System access controls</p> <p>Our testing has revealed a lack of overview with regard to system access controls. There are a number of instances where officers have access to systems which are not relevant to their</p>	<p>An annual review of systems access coordinated by Accountancy will be introduced across Accountancy, Revenues, HR and Payroll.</p>	<p>Margaret McCrossan Head of Accountancy March 2018</p>

Issue identified	Management response	Responsible officer and target date
<p>current post.</p> <p>Insufficient management control over systems access rights increases the risk of users either having unauthorised access to systems or access to inappropriate accounts.</p>		
<p>Main Accounting System: Feeder System Reconciliations</p> <p>The central finance sections have overall responsibility for maintaining the accuracy of the council's main financial ledger system. The transfer of balances between feeder systems and the financial ledger are carried out within a number of service departments e.g. payroll. We found that checks on the proper updating of all feeders systems to the financial ledger are not carried out by the central finance section. There is no evidence of an overview being carried out of all feeder reconciliations undertaken</p> <p>Insufficient review of feeder reconciliations increases the risk of incorrect and incomplete information being contained within the finance ledger.</p>	<p>Departmental staff currently carry out these reconciliations. Evidence of this will be improved in future by a senior staff member reviewing and signing off that the reconciliation has been properly completed regularly and timeously. Finance Business Partners will check twice yearly that reconciliations are being kept up to date. Finance Business Partners already confirm as part of the annual accounts process that reconciliations are up to date.</p> <p>As the Council seeks to further modernise its financial systems we will seek opportunities to automate reconciliations as far as possible.</p>	<p>Margaret McCrossan Head of Accountancy March 2018</p> <p>Margaret McCrossan Head of Accountancy August 2020</p>
<p>Payroll: Employee validation exercise</p> <p>In line with good practise, a full employee validation exercise was undertaken by the council in 2016/17. These required managers from across the council to confirm the validity of payroll employees. However, there is a lack of audit trail available to evidence that checks were undertaken on potential issues raised. In addition, there has been no formal report on the outcome of the exercise is not prepared for review by management.</p> <p>There is a risk that Management are unaware of the overall outcome of the exercise and formal records on the results of validation review are not maintained.</p>	<p>Since annual employee validation exercise commenced 7 years ago there have been no "ghost" employees found on the system. The results of this exercise are kept and checked by HR management to determine if any action is required. A formal report will now be introduced from 2017/18.</p> <p>However it should be noted that in addition to the payroll exercise there is also an annual finance staffing review carried out by the Finance Business Partners with managers as part of the budget process which provides a second opportunity for any potential errors in the Payroll. This is performed independently of the HR and Payroll system administrators. Departments are also issued with detailed workforce statements on a 6 monthly basis which allows a third opportunity to check the data.</p>	<p>Sharon Beattie Head of HR, Customer and communications June 2018</p>

Issue identified	Management response	Responsible officer and target date
<p>Payroll: Formalisation of payroll reconciliation</p> <p>There is a number of payroll system to general ledger reconciliations completed on a monthly basis. However, these are not evidenced as being reviewed and dated to show they are being completed on a timeously basis.</p> <p>There is a risk that there is a lack of audit trail on the review of the payroll reconciliations.</p>	<p>The annual reconciliation is reviewed, signed off and checked by the Head of Services and the Chief Accountant. The monthly reconciliations are all saved to an online folder so the date stamp can be seen to check they were completed on a timeous basis. A formal review process of the Payroll reconciliations will be considered as part of the improvement work through the digitisation of processes.</p>	<p>Sharon Beattie</p> <p>Head of HR, Customer and communications</p> <p>December 2017</p>
<p>Creditors: Duplicate/erroneous supplier payments</p> <p>As part of the process for making creditor payments, the council's procedures require officers to deploy software which produces reports on potential duplicate payments to creditors, for example where invoices have the same invoice number or other parameters such as invoice amount, date and supplier are the same. Internal audit reported during 2016/17 that this software had not been run for a period of 9months. Recent planned Internal Audit work established that the software had not been working appropriately in 2016/17 and in 2017/18 to date.</p> <p>There is a risk of duplicate payments to creditors and a loss to the council.</p>	<p>Invoice payment processes have been through significant transformation since they were transferred to Corporate & Community Services in February 2016. The Creditors service has worked closely with Internal Audit throughout that period. A routine Internal Audit of Creditors was due in 2017/18. Given the level of change, management requested that the audit be carried out as early as possible in the financial year to ensure a robust level of controls remained in place, particularly since centralisation of invoices in January 2017. This audit work is ongoing with management to develop a robust improvement plan to address any issues arising.</p> <p>Management are committed to ensuring sound financial control procedures are maintained and, where necessary, enhanced as the service works to build on the substantial performance improvements that have been made since the transfer of the service last year. This will include further modernisation of process and introduction of increased automation to minimise scope for manual error.</p> <p>There are 3 key controls to prevent duplicate payments are:</p> <ol style="list-style-type: none"> 1. The AP Forensics software, which management believed had been run automatically before each payment run since the Internal Audit report in autumn 2016. 2. A manual check on all payments over £10,000 to ensure accuracy, prior to each payment run. 3. The National Fraud Initiative which the Council carries out every 2 years and reports to Audit & Scrutiny Committee. 	<p>Louise Pringle</p> <p>Head of Business Change and Revenues</p> <p>December 2017</p>

Issue identified	Management response	Responsible officer and target date
	<p>The ongoing Internal Audit work highlighted that the AP Forensics system had not been fully implemented last autumn. It had been partially implemented, thus allowing Creditors staff to only do manual checks for duplicate payments prior to each payment run and, while this did prevent some duplicates, it was not as effective as it could have been if the full parameters of the software capability had been used. Management took immediate action to rectify this when this was highlighted in July as an emerging finding from the ongoing audit work and AP Forensics is now fully functional. In due course there will be further audit work to assure the new procedures.</p> <p>Internal Audit and the Finance Business Partners have conducted a detailed retrospective analysis of potential duplicate payments from 2015/16 and 2016/17. This work is currently being concluded, however the Head of Accountancy is assured that there is no material effect on the annual accounts and that appropriate arrangements have been put in place, as per existing procedures, to ensure that any genuine duplicate payments are promptly recovered</p> <p>As per usual procedures, all individual payments over £10,000 continue to be subject to checks by supervisors prior to each payment run.</p> <p>The biennial National Fraud Initiative exercise is in its final stages for 2017 and will be reported to Audit & Scrutiny Committee as part of normal business later this year.</p>	
<p>Creditors: Duplicate/erroneous supplier payments</p> <p>Further testing undertaken by both Internal Audit and external audit has highlighted that the system will permit duplicate/erroneous creditor payments to be made where there are slight variations in the same supplier code. This has resulted in multiple supplier codes existing for the same supplier.</p> <p>There is a risk of overpayments to creditors and a loss to the council.</p>	<p>The Creditors team is currently involved in a significant project to achieve business efficiencies from the use of the e-financials system. One element of this, scheduled for later this year, is a purge of old supplier data, particularly for those suppliers with no recent activity with the Council. Thereafter a housekeeping exercise to identify multiple references for the same supplier will be carried out, permitting the number of supplier codes to be reduced. This will reduce the risk of further duplicate payments.</p>	<p>Louise Pringle Head of Business Change and Revenues</p> <p>March 2018</p>

Issue identified	Management response	Responsible officer and target date
Follow up of 2015/16 HR and Payroll access		
<p>Main Accounting System: System access</p> <p>Currently 5 officers have 'supervisor user' access accounts which gives them access to both HR and Payroll functions on the payroll and HR systems. These "supervisor user" accounts are used to perform operational activities and system administration activities. Good practise would suggest in order to maintain an audit trail of activity, that these roles are segregated into different accounts. Additionally, there is no control in place to restrict staff access to either function. The council had responded that it intended to introduce a signed form for all staff that would mean that staff wouldn't process in both systems.</p> <p>There is a risk that HR and payroll system functions are not adequately segregated and some members of staff have access to both without the necessity for approval by another party.</p>	<p>There are now four officers with supervisor access - two in HR and two in Payroll. There is a requirement to have supervisor access to cover job roles and ensure resilience within the team. It is not possible to segregate the roles as the e-HR and Payroll is one system. The supplier of the system has been consulted on this and has confirmed there is no way to do this. The full system is auditable so there is no requirement to segregate into different accounts as a review of the one account can show where any user has been updating. Instead the main system administrator has spoken to Northgate about introducing an audit report which could be run independently of the supervisors for a regular check. These reports will be set up when the supplier consultant is next onsite August/September.</p> <p>There are checks already in place to ensure that any of the supervisor access roles cannot act independently to add a "new" employee to the system; when a new employee is added an automatic alert email is sent to HR Direct, Payroll and ICT, and the line manager. System generated e-mails are also sent to the Payroll and HR Direct mailboxes when contract changes including pay and hours are changed. In addition the OrgPlus system is fed from the HR and Payroll system with updates carried out weekly and this then displays all employees on the system. This update is currently carried out by the system administrators however it is proposed this is moved to an independent part of the team to provide more robustness in the process.</p> <p>A signed form will be introduced for all staff stating that they will not process in both systems, unless there is a specific request to do so and such an event would be recorded.</p>	<p>Sharon Beattie Head of HR, Customer and communications October 2017</p>

Source: Audit Scotland

17. All our outputs and any matters of public interest will be published on our website: www.audit-scotland.gov.uk.

East Renfrewshire Council

Interim Audit Report 2016/17

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