SUBSTANTIAL ASSURANCE

Payroll

Each year we review elements of the Council's Payroll system which is managed by financial services provider, Mouchel. As part of the 2011/12 audit plan we have covered the following areas:

- starters
- leavers
- pay claims
- travel claims
- payroll processing

The Payroll system is used to process salary payments, additional pay claims and travel expenses for all Council staff – deductions are then made and passed to statutory bodies.

Our opinion is based on a review of Mouchel central processes and testing of directorate transactions and results from our 2011/12 school visits. We have considered the common themes arising out of the school audits and have incorporated recommendations, where necessary, to encourage organisational learning and best practice in all Lincolnshire schools.

Executive Summary

Assurance Opinion – Substantial

We confirm that the controls within the payroll system are strong and overall continue to operate effectively. Our assessment provides a high level of confidence regarding the Mouchel service delivery and the general level of compliance within Council directorates and the school environment.

Our assurance is not absolute and is, as always, dependent upon consistent application of the controls. Over the year a small number of frauds within the school environment have affected the level of confidence in this area. Action has, however, been taken during 2011/12 to raise awareness of the risk of fraud within the school setting but this knowledge and understanding needs to be sustained to remain effective.

We also noted some gaps in the recruitment checklists relating to new starters in schools – we have established that this is a communication issue and not a significant control weakness.

The centrally held pre-employment checklists for new starters in schools were not always fully completed – we found gaps in the following areas:

- employee eligibility to work within the UK

- confirmation of CRB clearance prior to the start of employment and contract issue
- qualification verification, where necessary

Schools are responsible for carrying out the pre-employment checks, retaining the evidence on file and providing confirmation to the Human Resources team. We can confirm that the schools held the requisite evidence for all the checklist gaps identified within our sample. The checklist does, however, act as a safety net, improving compliance, helping to reduce the risk of recruitment fraud by confirming that due diligence checks have been made. Mouchel should ensure they receive confirmation in all key areas of the checklist prior to setting up a new starter on SAP and issuing the contract of employment.

We found that the e-recruitment process had been working well since its introduction, improving the accuracy of new starter information uploaded to SAP. However, during a walkthrough of the new starter process we found that the Payroll team were experiencing problems with the e-recruitment interface with SAP. Adequate measures were introduced and although these delayed the setting up of new starters, it provided continued assurance around the verification process. The interface problems were thought to be caused by the year end – attempts to resolve the problem were ongoing at the time of the review.

Audit work undertaken in schools during 2011/12 has generally shown a high level of compliance. The only issue identified involved the authorised signatory list – this has become less of an issue with the introduction of the e-claims system. This process does, however, rely on strong password security – there are sound user rules, training and guidance on password control but the security arrangements are dependent upon compliance. A common finding in recent fraud cases within the school environment was the sharing of passwords – the risks associated with this practice and the consequences of non-compliance need to be frequently communicated to all payroll users and authorised officers.

The control environment around payroll should be strengthened further during 2012/13 as the Counter Fraud and Investigation team plan to develop data analysis techniques in this area. This will be designed to identify fraud and error.

We noted numerous areas of good practice including:

- monthly checks on a sample of 25 manual (route 3) claims received from across the directorates
- accurate accounting of pay and travel claim payments
- payroll processing has been tested during 2011/12 and found to be operating effectively throughout.

Management Response

Mouchel

People Services management are again extremely pleased that it has been recognised that there continues to be good controls around the Payroll and HR Administration processes.

Mouchel recognises there are still areas of improvements that are required to gain full assurance. We will continue to review processes and the correct procedures reiterated to

staff. People Services management will continue to complete random sampling of staff input onto payroll and monitor that correct procedures have been followed. A Quality Management System has been rolled out across HR Administration and Payroll which further substantiates the checks we have in place. All individuals and Managers also have the objective to provide Quality and Assurance on a monthly basis.

All risk recommendations listed for Mouchel in the 2010/11 Audit have been completed. Where issues have been highlighted for the 2011/12 Audit which have a joint responsibility, Mouchel are more than happy to work with LCC to ensure they are progressed.

LCC

The audit opinion is welcome. It recognises the improvements that have been made to systems and processes in recent years. There is a strong commitment to address the outstanding issues.

The risks associated with schools are acknowledged and the Council and Mouchel will continue to work together to ensure that schools understand and are able to address those risks.

LIMITED ASSURANCE

Creditor Payments

Our review of the Creditor Payments system covered processes managed by financial services provider, Mouchel and procedures operated by Council staff. Our audit focused on the following areas:

- Masterdata
- Purchase ordering
- Invoice processing
- Payment runs

The Creditor Payments system is used to place orders and process invoices for payment. Throughout each of the directorates employees are authorised to process orders and certify invoices within certain agreed limits. Our opinion incorporates the testing results from the Council directorates and the school audits during 2011/12.

Assurance Opinion – Limited

Our analysis shows evidence of widespread non compliance with a mandatory element of Financial Procedure 5, specifically around the use of official orders, across all directorates – 69% of all orders raised over 2011/12 were retrospective (see Appendix I). This reduces the level of confidence around the effectiveness of the controls in this area, value for money and may, in some service areas, impact on sound budget management.

Procurement Lincolnshire recognise this issue and continue to work with budget holders to improve procurement practice – whilst the introduction of the E-Purchasing system will help, it may not resolve the issue of managers bypassing prescribed systems – the use of retrospective orders is long standing and deeply embedded in directorate custom and practice.

We found the Creditors system and control design to be fit for purpose, providing the Council with an efficient means of processing orders and paying for goods and services. This control framework should, *if complied with*, provide the assurance that this system will achieve the expected outcomes. The issue for the Council is around compliance and this affects the level of assurance.

The masterdata controls have been improved since last year – testing results for Council directorates show that requests to create new vendors or change existing vendor details are now properly authorised and validated. However, we found no method of verifying the authorised signatures for those masterdata requests originating from schools. We also note that the levels of authority did not match approved policy in over a third of schools audited over the year (see Appendix III).

The payment run process carried out by Mouchel is well established and our review confirmed this area is operating effectively – we found that payments are being made correctly and in accordance with predetermined timescales.

Financial Procedure 5 (Ordering and Payments) states that the Council's procedures should help Directorates obtain value for money from their purchasing arrangements. It is also a key requirement of the procedure that payments are recorded accurately and on a timely basis.

Official purchase orders provide the Council with control over its procurement activities and ensure timely commitments against the budget. Their use is a mandatory requirement of the Council's Financial Procedures and compliance is imperative to help ensure service areas operate within budget. The routine use of retrospective purchase orders is purely to facilitate payment of invoices and therefore undermines the Council's control environment.

The Financial Procedures recognise the continuously changing environment and allow some flexibility, but are clear there should be a convincing need for any departure – which should be the exception not the norm. Over two thirds of the Council's purchase orders in 2011/12 were raised retrospectively (i.e. after the invoice date). We also identified that the same service areas tend to be responsible for raising orders in this way (refer to Appendix II).

The use of retrospective orders will become more difficult when the E-Purchasing system is operational; it will not, however, guarantee compliance. With a new procurement system and focus on tight financial control, now is an opportune time for the Council to provide a mandate for budget holders around:

- compliance expectations (mandatory elements of Financial Procedures)
- increasing the use of framework orders for ongoing commitments
- working with Procurement Lincolnshire to explore alternative, innovative and cost effective procurement solutions, where there is an identified need to use anything other than prescribed purchasing options.

During the last 12 months Mouchel have improved procedures to ensure changes to existing masterdata records are valid and appropriately authorised. The procedures were strengthened but only following a change of bank details scam early in the last financial year. Our findings confirm that the revised process is sound and checking procedures thorough. In January this year Procurement Lincolnshire became responsible for the approval of all new vendors – this will, over time, increase the assurance that the Council deals only with reputable suppliers, offering value for money – it will also help to control the quality of supplier masterdata on SAP.

The new e-purchasing process notes state there is no requirement for change requests to be authorised as the original vendor request will have been certified. To minimise the opportunity for fraud, we advise that changes to vendor data are properly validated and authorised before referral to the Masterdata Team.

The e-purchasing procedures include suitable controls for the e-authorisation of new masterdata requests originating from Council directorates. However, there remain concerns over the authorisation of masterdata requests from Schools, as there is no clear method of verifying the signature of the authoriser.

The audit work undertaken in schools during 2011/12 has shown a high level of compliance with procedures for ordering goods and services, invoice processing and control of imprest

accounts. A common finding within the school environment related to the key control of authorisation – in a third of schools visited, the delegated limits were not properly defined within the school's finance policy.

Management Response

LCC

This audit report has been useful in confirming that, in general, the creditors system is working effectively, i.e. payments are being made accurately and on time.

The concerns regarding one particular area, i.e. retrospective orders, are acknowledged and management have suggested a number of actions which will hopefully improve the position. Management accept that controls in this area are important and finance regulations should be complied with at all times. However, this practice has been prevalent since SAP was introduced a decade ago and it is not always clear why this approach is taken or what the impact of that has been over this period of time.

Agreed Action

Three of the five agreed actions have an implementation date of 30 September 2012, one has an implementation date of 31 October 2012 and one is to be completed by 31 October 2012.

Procurement Cards

The purpose of this audit was to provide assurance that there are effective arrangements to meet the key objectives of Procurement Cards. These have been identified as:

- Procurement Cards are being used appropriately in accordance with guidelines
- Adequate documentation is retained to support expenditure
- Adequate security arrangements are in place re access to cards and authorisation of expenditure, and
- Effective management controls are in place to monitor levels of spend and types of expenditure

Procurement Cards were introduced to Lincolnshire County Council to streamline the purchasing process for low value orders, eliminating the need for unnecessary paperwork and procedures. It is estimated that each transaction processed via Procurement Card, rather than through the Purchase Order System provides a potential saving to the Authority of £11.91 per transaction. Based on the total number of transactions for the financial year 2011/12 (31,527 transactions), this represents a potential saving to the Authority of over £375,000.

Executive Summary

Assurance Opinion – Limited

We found that, whilst the Procurement Cards arrangements are basically sound, there are weaknesses which could impact on the expected outcomes of the system.

Our review identified that there are improvements required in key areas:

- the need for the Procurement Section to undertake random audits of card holders to deter potential misuse, ensure policy compliance and identify any training needs. Priority should be given to those cardholders without Administrators responsible for reviewing transactions, those with the highest credit limits, highest volume of spend and those who are also budget holders.

  We found that despite some cardholders being solely responsible for reviewing and authorising their own card expenditure, the Procurement Section has not undertaken any ad-hoc checks/audits. This lack of supervisory check increases the risk of card abuse.

- cardholders should obtain valid VAT receipts/invoices for all transactions and ensure that VAT is reclaimed on all relevant expenditure items. We found that the Council missed the opportunity to reclaim VAT on 43% of transactions within our sample (3.3% of total sample spend). VAT compliance will vary from one service area to another, however, these results highlight the need for VAT refresher training to reduce costs and maximise the use of resources.

Over 10% of the transactions tested were not supported by a receipt or invoice, 6% of which related to one cardholder – these tended to relate to on-line transactions requiring the purchaser to print the receipt. Missing receipts can also be a fraud indicator – it is imperative, therefore, that cardholders/Administrators track down any missing receipts.

We also found discrepancies with the maintenance of the Transaction Logs which are used for the monthly reconciliation and review process. The compliance issues identified in this area reduces the overall confidence in the checks being undertaken by the card Administrators/cardholders i.e. to ensure all expenditure is legitimate and reconciles to the bank statement, that valid VAT receipts have been obtained and that VAT is being reclaimed wherever possible.

In addition to reviewing central arrangements, we visited locations across the Authority to test adherence to the Procurement Card procedures. Some of our findings were minor in nature (low risk) and were discussed with the relevant staff member at the time of the visit. We have also recommended a number of low priority actions with Procurement Lincolnshire – these do not feature within this report.

We found some areas of good practice:

- Procurement Card guidance is clear and detailed

- Cardholders and Administrators are provided with regular training and support from the Procurement Team, including security arrangements
- Procurement Cards are being used for appropriate expenditure
- CentreSuite is generally updated with accurate procurement information by the monthly deadline – timely corrective action is taken by the Procurement Team on any exceptions
- Procurement Card limits are appropriate for both single transactions and monthly limits
- Regular reports are produced and reviewed by the Procurement Team to analyse levels of spend and types of expenditure i.e. to identify expenditure which should have gone through an existing contract or for which a new contract could be considered.

Management Response

Head of Procurement Lincolnshire – I am satisfied that the audit has covered all appropriate areas and I accept the recommendations. Procurement Lincolnshire has already begun to implement the recommendations.

Procurement & Contracts Officer – I fully support the findings and recommendations of this report. The agreed actions should assist in formalising current procedures and ensure that the use of Procurement Cards within LCC are in line with our policies and procedures.

The Procurement Lincolnshire team will carry out random audits on card users to ensure processes are being followed. The importance of VAT receipts will be reiterated to card users via a PCard Newsletter and inclusion in training. Recommendations will be implemented by the 30th June 2012.

Agreed Action

All agreed actions have been implemented and the process of random audits of cardholders is ongoing.