ABERDEEN CITY COUNCIL

COMMITTEE	Audit, Risk and Scrutiny Committee
DATE	25 September 2018
REPORT TITLE	Internal Audit Report AC1901 – Creditors Payments
REPORT NUMBER	IA/AC1901
DIRECTOR	N/A
REPORT AUTHOR	David Hughes
TERMS OF REFERENCE	2.2

1. PURPOSE OF REPORT

1.1 The purpose of this report is to present the planned Internal Audit report on Creditors Payments.

2. RECOMMENDATION

2.1 It is recommended that the Committee review, discuss and comment on the issues raised within this report and the attached appendix.

3. BACKGROUND / MAIN ISSUES

3.1 Internal Audit has completed the attached report which relates to an audit of Creditors Payments.

4. FINANCIAL IMPLICATIONS

4.1 There are no direct financial implications arising from the recommendations of this report.

5. LEGAL IMPLICATIONS

5.1 There are no direct legal implications arising from the recommendations of this report.

6. MANAGEMENT OF RISK

6.1 The Internal Audit process considers risks involved in the areas subject to review. Any risk implications identified through the Internal Audit process are as detailed in the attached appendix.

7. OUTCOMES

7.1 There are no direct impacts, as a result of this report, in relation to the Local Outcome Improvement Plan Themes of Prosperous Economy, People or Place, or Enabling Technology, or on the Design Principles of the Target Operating Model.

7.2 However, Internal Audit plays a key role in providing assurance over, and helping to improve, the Council's framework of governance, risk management and control. These arrangements, put in place by the Council, help ensure that the Council achieves its strategic objectives in a well-managed and controlled environment.

8. IMPACT ASSESSMENTS

Assessment	Outcome
Equality & Human Rights Impact Assessment	An assessment is not required because the reason for this report is for Committee to review, discuss and comment on the outcome of an internal audit. As a result, there will be no differential impact, as a result of the proposals in this report, on people with protected characteristics.
Privacy Impact Assessment	Not required
Duty of Due Regard / Fairer Scotland Duty	Not applicable

9. APPENDICES

9.1 Internal Audit report AC1901 – Creditors Payments.

10. REPORT AUTHOR DETAILS

David Hughes, Chief Internal Auditor
David.Hughes@aberdeenshire.gov.uk
(01467) 537861

Internal Audit Report

Finance

Creditors Payments

Issued to:

Steven Whyte, Director of Resources
Sandra Buthlay, Interim Chief Officer – Finance
Fraser Bell, Chief Officer – Governance
Andrew How, Chief Officer – Digital and Technology
Carol Smith, Accounting Manager
Graham Stubbins, Finance Partner
External Audit

EXECUTIVE SUMMARY

The Council uses the Payables module within their financial management system (eFinancials) to make payments to its suppliers. During 2017/18, payments totalling £737.9 million were made to 9,520 creditors. Of this, £275.5 million to 3,977 creditors was processed from nine feeder systems which process invoices / remittances outwith the payables module of eFinancials.

During 2016/17, another Scottish Local Authority identified a significant fraud perpetrated by a long serving member of staff, with extensive access to several Council systems. They combined their knowledge of these systems with their unrestricted system access privileges, to insert fictitious invoices into the creditors system for payment.

The objective of this audit was to provide assurance that there are adequate controls around the interface of payment data from named systems to the Creditors System (supporting documentation for and authorisation controls over input data, segregation of duties, accuracy and reconciliation of interfaced data sent and received) and that any associated balance sheet / suspense codes are reconciled on a regular basis.

In general, controls in place were found to be adequate, with automated system checks of files transmitted from feeder systems to eFinancials, appropriate reconciliations completed by Finance, and adequate insurance cover.

However, a number of recommendations have been made to improve creditor interface controls, including: the preparation of written procedures that clearly describe the flow of creditor invoice data from feeder systems to payment; where manual intervention can take place and the related controls; the introduction of feeder system to eFinancials reconciliations by staff unable to modify invoice batches submitted from feeder systems; ensuring BACS payment files are reconciled to eFinancials by more than one person; introducing a review of changes to creditor interface text files; and, introducing payment data analysis to identify manual changes to payment text files.

1. INTRODUCTION

1.1 During 2016/17, another Scottish Local Authority identified a significant fraud perpetrated by a long serving member of staff, with extensive access to several Council systems. They combined their knowledge of these systems with their unrestricted system access privileges, to insert fictitious invoices into the creditors system for payment. These invoices appeared to come from feeder sub systems interfacing with the creditors system and were payable to known suppliers. The feeder sub systems did not record these transactions. The employee was able to intercept these fictitious invoices and divert payment to bank accounts within the individual's control. A genuine payment to the supplier would not be intercepted, resulting in the supplier concerned being paid on time.

1.2 Aberdeen City Council uses the Payables module within their financial management system (eFinancials) to make payments to its suppliers. During 2017/18, payments totalling £737.9 million were made to 9,520 creditors. Of this, £275.5 million to 3,977 creditors was processed from nine feeder systems which process invoices / remittances out with the payables module of eFinancials. These feeder systems are:

System	Invoices	Gross £
Confirm – Non HRA property repairs	6,092	2,546,005
SEEMIS – Education Maintenance Allowance to pupils	4,317	262,440
Clothing Grants – payments to parents for pupils uniform	1,530	136,630
Spydus – Library management System	1,038	416,141
NDR – Refunds of Business Rates	971	5,813,878
Total – HRA Building Maintenance and Roads	23,426	27,392,714
PSE – Payroll funding and statutory payments	564	162,765,243
Tranman – Vehicle Maintenance & hire vehicles	10,904	2,753,896
CareFirst – Social Work care packages	36,721	73,371,620
Total From feeder Systems	85,563	275,458,567
	44.70%	37.33%
Total Invoices Processed	191,419	737,892,990

1.3 The objective of this audit was to provide assurance that there are adequate controls around the interface of payment data from named systems to the Creditors System (supporting documentation for and authorisation controls over input data, segregation of duties, accuracy and reconciliation of interfaced data sent and received) and that any associated balance sheet / suspense codes are reconciled on a regular basis.

1.4 The factual accuracy of this report and action to be taken with regard to the recommendations made have been agreed with Carol Smith, Accounting Manager, Graham Stubbins, Finance Partner, and Jamie Kirkwood, ICT.

2. FINDINGS AND RECOMMENDATIONS

2.1 Written Procedures and Training

2.1.1 Comprehensive written procedures which are easily accessible by all members of staff can reduce the risk of errors and inconsistency. They are beneficial for the training of current and new employees and provide management with assurance of correct and consistent practices being followed, especially in the event of an experienced employee being absent or leaving.

2.1.2 There are written procedures relating to the actions required by feeder system staff and ICT in relation to the interface of payment data from feeder systems to the creditors system. However, it was noted that whilst procedures are in place, detailed system notes and mapping which articulate the flow of transactions and explain how interfaces work were absent from these procedures, meaning it was not possible to understand easily the flow of transactions, when manual intervention is required, and the controls in place.

Recommendation

Written procedures in relation to the interface of payment data from feeder systems to the creditors system should be reviewed to ensure they are sufficiently detailed, ensuring the flow of transactions via each feeder system to payment is mapped, including the points where manual intervention takes place and the controls in place.

Service Response / Action

Agreed. A high level flowchart will be prepared documenting the flow of transactions from feeder systems to payment, where manual intervention can take place and the controls in place. The Creditors Interface Processing procedure will be expanded to detail the manual intervention that takes place in response to errors in the Batch Report (step 5 of procedure) and the related controls.

Implementation Date	Responsible Officer	Grading
November 2018	Finance Partner	Significant within audited area

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2.2 System Controls

2.2.1 Output files are generated from the feeder systems, either as part of a scheduled automated process, or when instigated by the system administration staff. The output file produced, which picks up all completed transactions since the previous output, is exported in a text format and saved onto one of the function's network drives. An automated process uplifts the text file from the server and places it on the Clink (link and load) area within e-Financials. The uplift is automated but can be carried out manually in the event of a processing failure. The text file is then vetted by the system to ensure it complies with the correct format and detail which, if successful, allows it to be fully uploaded into the creditors sub ledger system.

2.2.2 The process for making the BACs payment, also produces a text file, this time output from eFinancials, for transfer to the BACs system. While there is no requirement for manual intervention after accounts payable staff run the process within eFinancials, the text file produced is accessible by ICT staff who have specific administration privileges for that system.

2.2.3 ICT confirmed that access to feeder system text files is restricted to ICT staff who support the feeder system concerned and the system administrators. There is no automated audit trail of who has made changes to the text files once saved outwith their respective feeder

systems however requests for changes to be made to text files are logged in the ICT case management system Service Now.

2.2.4   The current process requires any errors which prevent the transaction from being successfully uploaded to be corrected within the text file, rather than being returned to the source feeder system, to be corrected and retransmitted. The current process requires any errors which prevent the transaction from being successfully uploaded to be corrected within the text file, rather than being returned to the source feeder system, to be corrected and retransmitted. The 'Invoice load from feeder systems to eFinancials Creditors' procedure details the names of ICT staff who support the systems and the system administrators, who ICT confirmed can access and edit feeder system text files, as well as the process to be followed when editing text files and the required authorisation. An equivalent list of staff who can access and edit BACS text files and a procedure documenting the process to be followed when editing BACS text files is also in place. This details the authorisation required prior to amending BACS text files.

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Recommendation
Finance should review access permissions to input 'Clink' files in eFinancials and restrict them as far as possible.

Service Response / Action
Finance will countersign all changes to input text files prior to processing.

Implementation Date	**Responsible Officer**	**Grading**
November 2018	Finance Partner	Significant within audited area

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2.3   Interface Reconciliations

2.3.1   When the interface process is initiated, the feeder system or system administrator will issue an email detailing the batch control total, number of transactions, VAT value and gross payment value to email group ACC-Development. Prior to the transactions being uploaded onto eFinancials, they are held in a Clink table to be compliance checked by eFinancials as described in paragraph 2.2.1, above. Should any transactions fail, they are reported on an exception report and held pending correction; those that have no errors are loaded onto the creditors sub ledger.

2.3.2   At this stage one of the Finance Assistants will carry out a reconciliation between the email from the feeder system, and the batch total reported from the Clink table with any difference investigated with the feeder system administrator. This provides a batch level control for the totals which should be uploaded to eFinancials. Currently the ACC-Development team comprises three Finance Assistants, any one of whom can carry out the task, dependant on work load at that time. However, as these staff have responsibility for correcting any errors which arise when the upload to Clink occurs, they can edit text files on Clink. Therefore, there is a risk that information could be amended during the reconciliation process, without being independently checked.

2.3.3   Three of the feeder system staff carry out detailed reconciliations between eFinancials and their respective feeder system: Spydus, PSE & NDR. This is achievable due to the relatively small number of transactions being processed by these interfaces. This reconciliation provides an independent check to the details loaded onto eFinancials and should highlight any changes which were made after the original transaction file was exported from the feeder system. Currently the remaining systems' staff do not carry out any form of reconciliation to eFinancials, even at a batch total level. Should this be introduced this would reduce the risks highlighted in para 2.3.2, above. If this could be achieved by an automated exception report of reconciling differences being emailed to the

system administrators from eFinancials, this would keep the process to a manageable administrative check.

Recommendation
Recommendation A system of reconciliations between feeder systems' batch totals and those uploaded onto eFinancials should be investigated. **Service Response / Action** Agreed. The use of BOXI reports will be investigated, to automatically send details of what has been uploaded to eFinancials to the relevant system administrators for reconciliation purposes. **Implementation Date**   **Responsible Officer**   **Grading** December 2018   Finance Partner   Significant within audited area

2.3.4   The Accounts Payable Team manage the process for the creditors system, generating payments through an interface with the BACs system. The Team carry out a reconciliation of the number and value of transactions output from the creditors system and those loaded onto BACs. Where staff numbers allow, this reconciliation is signed off by two members of staff, one who checks the values match and approves the payment and the other who rechecks the values match and submits the payment. There are occasions where this may be carried out by the same member of staff.

Recommendation
Recommendation To maintain segregation of duties, two members of staff should complete the BACs reconciliation, approval and submission process. **Service Response / Action** Agreed.   This will be resolved when Business Services take over the BACS reconciliation, approval and submission process, which will result in an increase in the number of staff available to complete these tasks. **Implementation Date**   **Responsible Officer**   **Grading** December 2018   Accounting Manager   Significant within audited area

2.4   Balance Sheet Reconciliation

2.4.1   The financial ledger codes associated with the creditor records are not processed directly from the feeder system into the financial ledger. These transactions interface to the creditors module (known as a sub ledger) which then updates the relevant capital, revenue and balance sheet codes within the financial ledger.

2.4.2   The creditors sub ledger system holds the balance of monies due by the Council to its creditors based upon invoices / payment requests processed and the payments made, resulting in the balance outstanding. This financial analysis is also held within the creditors control account which is updated with the value of invoices / payment requests and the payments made, whether BACs, cheques or CHAPS. The individual feeder systems do not have their own control accounts which could be reconciled to the feeder system balances.

2.4.3   The Finance Partner, carries out a monthly period end reconciliation between the creditors control account balance and the outstanding debt within the creditors sub ledger to ensure they balance, and any imbalance is investigated. The reconciliations for the period 1 April 2017 to 30 April 2018 were tested and all found to balance.

2.5 **Transactional Testing**

2.5.1   Payments, whether for invoices or another form of payment voucher, require to be authorised by an appropriate member of staff before being processed through one of the feeder systems and across to the creditors module of e-financials. Each of the feeder systems as stated in para 1.2 have administrative staff within the functions to process these transactions.

2.5.2   With the exception of CareFirst, which has already undergone a full system audit, testing of a random sample of five transactions from the remaining feeder systems found authorised source documents were present for each.

2.5.3   The sample was then traced through the interface files and into the creditors sub ledger to ensure the correct supplier was updated with the correct value based on the payment voucher. All transactions were found to match.

2.5.4   Once the transactions have been updated on the creditors sub ledger they will await the reaching of the payment date, based on the supplier's payment terms. At this stage any vouchers which have fallen due will be amalgamated into a single payment which will result in either a BACs, CHAPS or cheque payment.

2.5.5   A sample of ten payments made per the creditors sub ledger was traced through to the BACs payment being processed to confirm the bank account to which the payment was made matched the bank details held in the creditors system's standing data. All details tested were found to match.

2.5.6   As detailed in para 2.3.4, above, the payment runs per the eFinancials and the BACs system are checked and approved prior to submitting for payment. A sample of six random payment runs was tested to ensure the values matched and they had been signed off as checked by the accounts payable staff. Testing was found to be satisfactory.

2.6 **Supplier Statements**

2.6.1   Supplier statements are received from some suppliers detailing invoices raised in a particular period, payments received and the outstanding balance owed by the Council. Originating Services and the accounts payable team do not carry out reviews of all statements received from creditors. However, Accounts Payable will review any invoices which appear as long outstanding on a statement or where it has been intimated to them payment has not been made. This would result in an investigation into the reasons why such a payment had not been processed.

2.6.2   In the fraud case referred to paragraph 1.1, above, fictitious invoices were created against suppliers which were subsequently paid on time. Therefore, the supplier would not have any invoices outstanding, and therefore no exception would appear on the related statement. To be able to identify such fabricated invoices, every statement would have to be matched to every invoice processed through the creditors system. This would be resource intensive since over 190,000 invoices are processed per annum.

2.7 **Payment Data Analysis**

2.7.1   The Internal Auditors of the Council that suffered the fraud referred to in paragraph 1.1, above, analysed payments as part of additional work in the wake of the fraud being discovered, to identify further anomalous payments. This included identifying suppliers with BACS payments to more than one bank account and comparing payment files in the purchase ledger and the BACS system to ensure they agree. Such checks are not routinely carried out by Finance.

> **Recommendation**
> A system of payment data analysis should be set up to ensure payments to suppliers agree with supplier standing data.
>
> **Service Response / Action**
> The Service will investigate whether it is possible to check that supplier bank account details per the Creditors system agree to bank accounts being paid by BACS and if so introduce a regular check.
>
> | **Implementation Date** | **Responsible Officer** | **Grading** |
> |---|---|---|
> | December 2018 | Finance Partner | Significant within audited area |

2.8   Insurance

2.8.1   The loss associated with the fraud referred to in paragraph 1.1, above, was partly covered by the Council's fidelity insurance policy. With the exception of the policy excess of £10,000, the remainder was recovered from the perpetrator's pension fund and from a voluntary payment from a third party. Aberdeen City Council has a Crime insurance policy that provides cover in the event of employee fraud, subject to an excess of £15,000 and policy terms and conditions being met.

AUDITORS: D Hughes
A Johnston
G Flood

Appendix 1 – Grading of Recommendations

GRADE	DEFINITION
Major at a Corporate Level	The absence of, or failure to comply with, an appropriate internal control which could result in, for example, a material financial loss, or loss of reputation, to the Council.
Major at a Service Level	The absence of, or failure to comply with, an appropriate internal control which could result in, for example, a material financial loss to the Service/area audited. Financial Regulations have been consistently breached.
Significant within audited area	Addressing this issue will enhance internal controls. An element of control is missing or only partial in nature. The existence of the weakness identified has an impact on a system's adequacy and effectiveness. Financial Regulations have been breached.
Important within audited area	Although the element of internal control is satisfactory, a control weakness was identified, the existence of the weakness, taken independently or with other findings does not impair the overall system of internal control.

Report No. AC1901