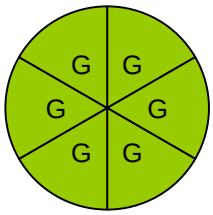
Internal Audit

Expenditure and Payables

September 2015

Report Assessment



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Introduction

Non-pay expenditure represents a significant outlay for the majority of public sector bodies. In the year ended 31 March 2015, NHS Lothian incurred approximately £881million in non-pay expenditure. NHS Lothian must therefore have robust processes in place to ensure that costs are authorised and justified in advance of the expenditure being committed. To support this, the NHS has dedicated systems in place, such as PECOS, to ensure that orders are approved in line with the scheme of delegated authority.

In line with Scottish Government's Payment Policy, NHS Lothian must endeavour to pay its suppliers within ten working days. Compliance against this target is monitored and the results are published as part of the Board's annual accounts. In the year ended 31 March 2015, NHS Lothian achieved a seven day average (2013/14 – eight days). In order to ensure this target is met it is important that NHS Lothian has efficient processes surrounding its non-pay expenditure.

Scope

The audit assessed the adequacy and effectiveness of NHS Lothian's controls over the order, receipt and invoice payment processes managed by Procurement and Accounts Payable, including compliance with the Payment Policy. This review did not cover supplier tendering and contract management, which will be addressed through a separate Procurement review during 2015/16.

Acknowledgements

We would like to thank all staff consulted during this review, for their assistance and cooperation.

Executive Summary

Conclusion

We can confirm that controls over the order, receipt and invoice payment processes are in the main operating effectively. However we have noted some issues which if addressed should improve the control framework. These include segregation of duties between the raising and approving of purchase orders, and ensuring the accuracy of PECOS and the Authorised Signatories Database.

Summary of Findings

The table below summarises our assessment of the adequacy and effectiveness of the controls in place to meet each of the objectives agreed for this audit. Definitions of the ratings applied to each action are set out in Appendix 1.

No.	Control Objective	Control objective assessment	Number of actions by action rating			
			Critical	Significant	Important	Minor
1	NHS Lothian has agreed policies and procedures in place for expenditure and payables.	Green	-	-	-	1
2	All purchases are authorised in advance of the order being placed with the supplier.	Green	-	-	1	-
3	All expenditure is verified, via a goods received note or equivalent, prior to the invoice being processed for payment.	Green	-	-	-	-
4	The correct suppliers are paid the correct amount once and in line with invoice payment terms.	Green	-	-	-	-
5	Expenditure is completely and accurately reflected in the accounting system.	Green	-	-	1	-
6	Creditors are paid promptly and NHS Lothian's performance against the SGHSCD Payment Policy is regularly monitored and reported.	Green	-	-	-	-

Control Objective Ratings

Action Ratings	Definition
Red	Fundamental absence or failure of controls requiring immediate attention (60 points and above).
Amber	Control objective not achieved - controls in place are inadequate or ineffective (21 – 59 points).
Green	Control objective achieved – no major weaknesses in controls but may be scope for improvement (20 points or less).

Main Findings

We noted a number of areas of good practice during the review. NHS Lothian uses the PECOS system for ordering approximately 58% of its goods and services, which has built-in controls for ordering and receipting goods. These controls enforce authorisation at the ordering and goods receipting stages, as well as allowing efficient payment of invoices where the value of the invoice matches the order, within the agreed tolerances. Where an order has not been raised through PECOS (such as pharmacy orders which are raised through the separate JAC procurement system), Accounts Payable requires the invoice to be manually authorised by the relevant department prior to payment.

On average, 13% of all invoices processed for April to July 2015 were for goods or services not raised through PECOS. This number excludes pharmacy, utilities and telecommunications, which have alternative procedures. This represents approximately 26% of the total value of all invoices for the same period. Finance staff are actively monitoring this with a view to reducing the number of invoices paid for goods or services without an order raised in the first instance. On 8 July 2015 the Deputy Director of Finance wrote to department heads reminding them that official orders must be used for all goods and services at the point of ordering.

Batch payment runs are approved for processing three times each week, following confirmation that checks over the completeness and accuracy of the payment run have been undertaken.

The Scottish Government Health & Social Care Directorate (SGHSCD) Payment Policy requires that public sector bodies aim for all invoices to be paid within ten days of receipt of invoice at the designated address. The time taken to pay each invoice (from the date of receipt) is recorded and monitored each month by senior finance staff. For April to July this financial year NHS Lothian paid 85% of its invoices within the 10 day target, with 94% of invoices settled within 30 days. NHS Lothian's performance in this area is reported monthly to SGHSCD.

We identified two important areas for improvement during the review:

- Our testing identified two instances where the same individual raised and authorised an order on PECOS. In these two instances the orders were worth £600 and £1,300.

- NHS Lothian maintains an Authorised Signatory Database (ASD), which should be reflected in the authorisation limits within PECOS. However, our testing identified two inconsistencies between the user information held in the ASD and PECOS.

Further details of each of these points, as well as one minor issue, are set out in the Management Action Plan.

Management Action Plan

Control objective 1: NHS Lothian has agreed policies and procedures in place for expenditure and payables.	
1.1: Financial Operating Procedures did not contain version control information	**Minor**
Observation and risk The Accounts Payable Team has developed a Financial Operating Procedure (FOP) for the accounts payable function. The FOP (which was last updated in October 2010) was in the process of being updated during the audit. However, we noted the updated FOP does not contain version control information. A lack of version control on the FOP may lead to the document not being regularly reviewed and becoming out-of-date, which may lead to staff following incorrect procedures.	
Recommendation All key accounts payable policies and procedures should include version control information. This should include date last reviewed, next review date, who should review it, where it is saved electronically, and which staff groups it has been issued to. Management should regularly review all key policies and procedures to ensure they remain up-to-date. Each document should be allocated a nominated "owner" and formal review dates should be agreed to ensure this happens.	
Management Response and Action All procedures should incorporate a version control page. The Accounts Payable FOPs will be amended to incorporate a version control page. A single document which contains policies and their review date will be developed and monitored to ensure that the formal review dates are adhered to.	
Responsibility: Head of Financial Control	Target date: Sept 2015

Control Objective 2: All purchases are authorised in advance of the order being placed with the supplier.	
2.1 No segregation of duties between individuals raising and approving orders on PECOS	**Important**
Observation and Risk The PECOS procurement system requires that all purchase orders are raised, approved and receipted prior to payment. We tested a sample of 24 purchase orders raised within the last year and identified two instances (8.3%) where the same individual raised and approved an order. In these two instances the orders were worth £600 and £1,300. Without segregation of duties between the individual raising and approving the order, there is a risk that NHS Lothian receives goods/services that it does not require, and incurs unnecessary financial cost to the organisation.	
Recommendation Procurement has agreed that segregation is not required between the requisitioner and approver as long as a second individual receipts the goods / services. However, good practice states that requisitioners and authorisers should be different individuals to ensure adequate segregation of duties before NHS Lothian makes a commitment to purchase. Management should investigate whether PECOS has the functionality to force different individuals to raise and authorise an order; if this functionality is possible then management should look to implement it. For smaller departments, segregation of duties could be achieved by identifying a wider pool of staff with the authority to raise requisitions. Management should explore whether exception reports can be run from PECOS to identify instances where the same person has raised and approved an order. Such reports should be run monthly and followed up with staff / departments.	
Management Response and Action PECOS Reporting does not currently allow us to track these; however a Change Request which goes live in November 2015 will allow this. All PECOS approvers who also have requisition rights will be written to asking them whether they wish to keep one or the other, not both, and PECOS will be amended accordingly. Non response will result in requisitioner rights being removed.	
Responsibility: Head of Procurement	Target date: March 2016

Control Objective 3: All expenditure is verified, via a goods received note or equivalent, prior to the invoice being processed for payment.
We identified no significant issues in relation to this control objective. NHS Lothian will only process and pay an invoice once the goods or services have been received. For orders raised through PECOS, there is a function to 'receipt' the goods, which then allows the invoice to be processed for payment through the eFinancials system. Where no purchase order has been raised, the invoices are signed off by the appropriate budget holder as approved in order for payment to be processed. Testing identified one purchase order (of 24 sampled) which had not been receipted in PECOS and yet had been processed for payment. Enquiries noted that this was for repairs carried out which required prompt payment and, once confirmed as completed by the department, the order had been receipted by a member of staff in Procurement.

Control Objective 4: The correct suppliers are paid the correct amount once and in line with invoice payment terms
We identified no significant issues in relation to this control objective. Accounts Payable processes a payment run three times per week. Before the payment run is finalised, accounts payable staff perform checks including a review of all Non-POP invoices valued over £10k, checking of a random sample of POP invoices, and a review of duplicate payment reports to confirm that suppliers are only paid once. The payment run is only approved by the Head of Financial Control or the Financial Controllers for processing after a Team Lead has confirmed that the various checks have been undertaken.

Control Objective 5: Expenditure is completely and accurately reflected in the accounting system.	
5.1: User information within PECOS does not match the Authorised Signatory Database	**Important**
Observation and risk NHS Lothian maintains an Authorised Signatory Database (ASD), which records financial authorisation limits for various staff and the cost centres for which they can approve expenditure. The information held within the ASD is used to determine user rights on PECOS. From our testing of 24 purchase orders we identified the following issues: • In one instance (4.1%) a purchase order on PECOS of £10,300 was approved by an individual whose ASD approval level was £5,000. • In one instance (4.1%) an individual approved an order on PECOS for a cost centre that was not within their delegated authority. There is a risk that members of staff can approve purchase orders within PECOS at a value that exceeds their permitted level or for cost centres that are not under their responsibility. This could lead to NHS Lothian incurring expenditure for goods or services that it does not require.	
Recommendation Finance should undertake a comprehensive reconciliation between the ASD and PECOS to verify the consistency of user authorisation limits and cost centres. Going forward all new users who are added to the ASD and PECOS should be counter-checked by a second member of staff to ensure that the user details have been added correctly. Evidence of this check should be retained.	
Management Response and Action Many of the occurrences relate to users who have had approval rights and levels altered as a result of the recent NHS Lothian restructure. The Procurement Helpdesk Team and ASD will work together to reconcile both systems and further refine the process for future reconciliation. Quality/Spot Checking will be introduced as part of this refinement.	
Responsibility: Head of Procurement	Target date: March 2016

Control Objective 6: Creditors are paid promptly and NHS Lothian's performance against the SGHSCD Payment Policy is regularly monitored.

We identified no significant issues in relation to this control objective.

The SGHSCD is committed to supporting business by paying bills more quickly and public sector bodies are required to aim for all invoices to be paid within ten days of receipt.

Therefore, the time taken to pay each invoice (from the date of receipt) is recorded and monitored each month by senior finance staff. NHSL monitors its own performance against the following KPIs:

- % of invoices by value, paid within 30 days
- % of invoices by volume, paid within 30 days
- % of invoices by value, paid within 10 days
- % of invoices by volume, paid within 10 days

For to the period to July 2015 NHSL's performance against these targets was as follows:

- % of invoices by value, paid within 30 days (95%)
- % of invoices by volume, paid within 30 days (94%)
- % of invoices by value, paid within 10 days (91%)
- % of invoices by volume, paid within 10 days (85%)

NHS Lothian's performance in this area is reported monthly to SGHSCD.

Appendix 1 - Definition of Ratings

Management Action Ratings

Action Ratings	Definition
Critical	The issue has a material effect upon the wider organisation – 60 points
Significant	The issue is material for the subject under review – 20 points
Important	The issue is relevant for the subject under review – 10 points
Minor	This issue is a housekeeping point for the subject under review – 5 points

Control Objective Ratings

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