

NHS Lothian

Internal Audit 2023/24

Core Financial Controls – Journals

October 2023

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It is the responsibility solely of NHS Lothian management and directors to ensure there are adequate arrangements in place in relation to risk management, governance, control and value for money.



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Executive Lead:	
• Craig Marriott, Director of Finance	
For action:	
• Olga Notman, Head of Financial Control	
For Information:	
• Calum Campbell, Chief Executive	
• Audit and Risk Committee	

Executive summary



Background

It's essential for organisations, especially one as prominent and expansive as NHS Lothian, to consistently evaluate, enhance, and strengthen their financial controls. Robust financial controls not only support transparency and precision, but they also promote operational efficiencies. This allows professionals to direct their focus on strategic financial planning and management, rather than routine operational intricacies.

Following risk-based discussions, our review of Core Financial Controls for 2023/24 has been split into two distinct areas. The reviews are as follows:

- Manual Journals – covered in this Audit Planning Brief
- Capital/Fixed Assets in Context of IFRS 16 'Leases' – covered by a separate Audit Planning Brief and report.

Manual Journals are a component of NHS Lothian's monthly and year-end financial reporting processes. Their manual nature exposes the Board to the potential for bottlenecks, inefficiencies and errors, which is increased where there is heightened intricacy and volume of transactions. When accountants, whose expertise comes at a premium, spend significant time on these manual and operational tasks, it may impact on the quality of the documentation and audit trail established, and not only elevate operational costs but detract from a more strategic financial focus.

Due to the detailed testing undertaken by External Audit on journals, we have not duplicated this. Instead, we have analysed the manual journal population highlighting areas where the Board could review controls to maintain assurance but potentially reduce to create efficiencies enabling staff to focus in other areas.



Objectives

Our review focussed on the following key risks:

- Inadequate documentation of established manual journal entry procedures, potentially resulting in misstatements and financial inaccuracies.
- Deviations from established manual journal entry procedures resulting in misstatements and/or an insufficient audit trail.
- Missed cost-saving opportunities, or misallocation of resources, leading to increased operational costs (Advisory).

Executive summary



Limitations in scope

Please note that our conclusion is limited by scope. It is limited to the risks outlined above. Other risks exist in this process which our review and therefore our conclusion has not considered. Where sample testing has been undertaken, our findings and conclusions are limited to the items selected for testing.

This report does not constitute an assurance engagement as set out under ISAE 3000.



Acknowledgement

We would like to take this opportunity to thank your staff for their co-operation during this internal audit.

Headline messages



Conclusion

Significant Assurance

We have reviewed the processes and controls around the Board's Core Financial Controls – Journals, and have concluded that the processes have provided a **Significant level of assurance**. This was confirmed through testing over specific areas and through discussions with management.

The objectives reviewed are set out below with the assurance rating we have assessed for each one and the number of recommendations raised. We have reported by exception against the areas where we consider that Management and the Audit and Risk Committee should focus their attention. Objective 3 is advisory in nature.

One low-risk recommendation has been raised as part of the assurance review part of our audit. This recommendation relates to an unapproved procedure for journal preparation and approval. Within the 'Advisory' part, which was based on data analysis of NHS Lothian's journals for the period 1st April to 28th September 2023, we have raised three improvement recommendations.

Risks	Assurance rating	Number of recommendations			
		High	Medium	Low	Improvement
Inadequate documentation of established manual journal entry procedures, potentially resulting in misstatements and financial inaccuracies.	Significant Assurance			1	
Deviations from established manual journal entry procedures resulting in misstatements and/or an insufficient audit trail.	Significant Assurance				
Missed cost-saving opportunities, or misallocation of resources, leading to increased operational costs.	N/A - Advisory				3



Summary of findings



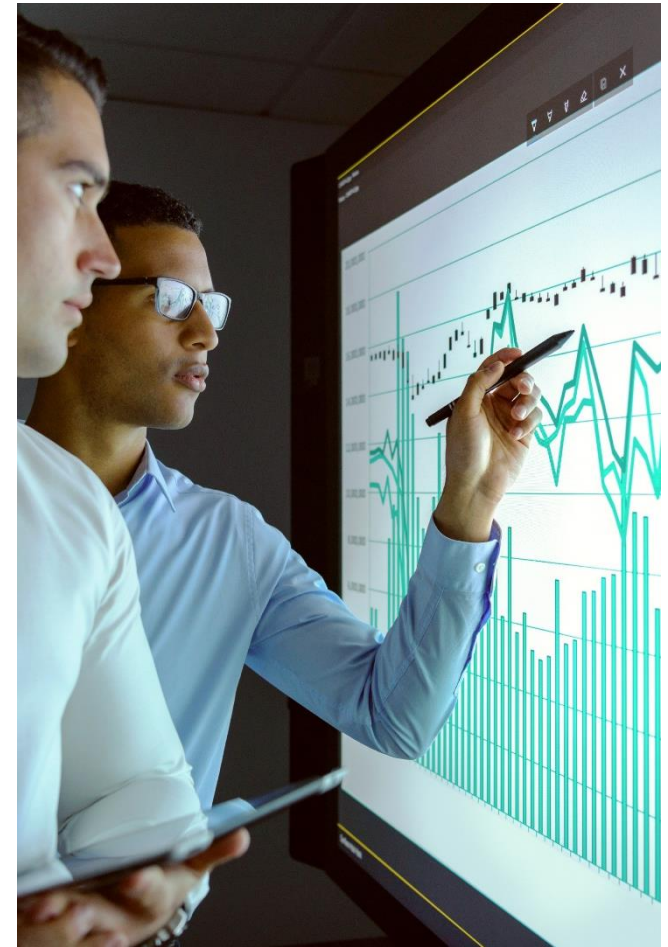
Examples of where recommended practices are being applied

- Implementation and operation of segregation of duties to minimise risk of fraud.
- All journals were posted in normal working hours with minimal posting being made at weekends. Which suggests a routine and systematic approach, which often leads to fewer mistakes.
- Journal sub-types and their descriptions are coherent and logical.
- The details pertaining to the creator and poster of the journal are clearly recorded and accessible.



Areas requiring improvement

- We found that the draft document "Financial Operating Procedures - Preparation and Approval of Journals" lacks formal approval.



Detailed findings & action plan

1.1

Significant Assurance

Inadequate documentation of established manual journal entry procedures, potentially resulting in misstatements and financial inaccuracies.

Finding and implication	Recommendation	Management response, including actions
<p><u>Unapproved Procedure for the Preparation and Approval of Journals</u></p> <p>We identified a weakness regarding the "Financial Operating Procedures - Preparation and Approval of Journals" which remains in a draft state and lacks formal approval.</p> <p>The document is comprehensive and offers a clear framework for creating, authorising, and managing manual journal entries, however, without formal approval and distribution, there's a risk that NHS Lothian staff may not adhere to the intended processing requirements for manual journals. This poses potential compliance and operational risks to the organisation.</p>	<p>Recommendation 1</p> <p>Formally approve and distribute the "Procedure for the Preparation and Approval of Journals".</p>	<p>Actions: The Financial Operating Procedures - Preparation and Approval of Journals will undergo internal approval</p> <p>Responsible Officer: Olga Notman, Head of Financial Control</p> <p>Executive Lead:</p> <p>Due Date: 31/01/2024</p>

Detailed findings & action plan

2.1

Significant Assurance

Deviations from established manual journal entry procedures resulting in misstatements and/or an insufficient audit trail.

Finding and implication	Recommendation	Management response, including actions
<p><u>Journal Totals Exceeding Authorisation Limits</u></p> <p>Testing of a journal export from 1st April 2023 to 28 September 2023 identified that, from 4,393 entries, 41 had total values surpassing the authoriser's limit. Breaking down the 41 exceptions, journal entries accounted for £1.04bn spread across 5 authorisers and Reversing Journals represented £0.46bn spread across 6 authorisers.</p> <p>Reasons for the Journals</p> <ul style="list-style-type: none"> • ACCRUAL: 29 entries (£0.45bn) • GENERAL JOURNAL: 1 entry (£0.03bn) • NATIONAL PAYROLL TRANSFER: 6 entries (£0.67bn) • RECHARGES: 2 entries (£0.26bn) • STAFF BANK: 3 entries (£0.08bn) <p>NHS Lothian communicated that the authorisation pertains to the journal line amount, indicating a control weakness relating to overall journal value authorisation.</p> <p>The key purpose of requiring approvals is to ensure that transactions are accurate, legitimate, and adhere to internal controls. If the aggregate amount exceeds the delegated limit, even with line-by-line approvals, there's potential for oversight or misuse. This can allow larger transactions to bypass the appropriate level of scrutiny by being broken down into smaller components.</p> <p>The finding has been discussed with management, who have acknowledged the associated risk. However, it has been determined that other compensating controls within the system provide an environment where this issue is not considered to warrant making changes. A formal recommendation has not been made.</p>	<p>Proposed Recommendation</p> <p>For transactions exceeding a certain value threshold, consider implementing whole-journal authorisation to improve efficiency and mitigate oversight risks.</p>	<p>Actions: N/A</p> <p>Responsible Officer: N/A</p> <p>Executive Lead: N/A</p> <p>Due Date: N/A</p>

Part 2: Journal review (Advisory)



Data analysis of the NHS Lothian journal export.

In our assessment of operational cost efficiency and resource allocation, we completed a comprehensive analysis of the journal export from 1st April 2023 to 28th September 2023. This had a total value of £4.54bn across 4,393 entries.

Below is a summary of the areas of identified potential risk that could lead to elevated operational costs.

- Based on the analysis of the journal export a total value of £4.54bn was observed from 4,393 entries. Of these, entries marked 'Journal' accounted for £2.28bn, while 'Reversing' entries summed up to £2.25bn. When comparing these figures to organisational scale, NHS Lothian operates on a budget of approximately £2bn for the 2023/24 fiscal year. The high volumes of journals might elevate the risk of errors, potential fraud, and inefficiencies. While automated systems might reduce these risks, they can introduce systemic errors if improperly configured, besides incurring significant costs. **A recommended low-cost enhancement would be the implementation of routine, detailed training sessions for staff handling journal entries. Such an approach would not only bolster their expertise but would also ensure that the necessary processes are communicated effectively and comprehended accurately.**
- In our analysis of journal entries by value bands, 51.1% of "Journal" entries fall within the ranges of £1,001 to £25,000, which aligns with expectations. With reversing journals, as the value of the journal rises, the percentage of these entries also increases. Notably, those above £250,000 constitute 28.8% of all reversing journals. Both reliance on a small number of high-value journals and a large number of lower-value journals present unique challenges. Tailoring our improvement recommendation to NHS Lothian's journal population **we have suggested that implementing a secondary approval process or an automated flagging system for high-value reversals might be beneficial. This would offer an added layer of oversight, aiming to minimise potential issues or errors that may cause inefficiencies and evaluated costs.**
- There is an indication for the need to diversify authorisation responsibilities to bolster internal controls and reduce vulnerabilities in the journaling process. Currently, the responsibility of authorising "Journals" and "Reversing" journals is heavily reliant on a limited number of individuals. This concentration can introduce internal control concerns since it may increase the risk of oversight or potential improprieties during the authorisation. Furthermore, among the 21 active authorisers, many have a minimal role. As a recommended course of action, **NHS Lothian should consider distributing authorisation responsibilities more evenly among a broader group of qualified staff. In doing so, this would ensure that no single individual shoulders an overly large portion of the authorisation duties, providing a more robust journaling process.**

The subsequent sections contains further details and visualisations of our findings and where potential control weaknesses or risks are identified the corresponding improvement recommendations.

Detailed findings & action plan

3.1	Advisory	Missed cost-saving opportunities, or misallocation of resources, leading to increased operational costs.
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Finding and implication	Improvement recommendation	Management response, including actions
<p><u>Significant Count of Journals</u></p> <p>Analysis of the journal export provided for 1st April 2023 to 28th September 2023, showed a total value of £4.54bn across 4,393 entries.</p> <p>Entries labelled as 'Journal' totalled £2.28bn and 'Reversing' totalled £2.25bn. The distribution of values and counts among journal entries are represented in two pie charts on the following page.</p> <p>The volume of journals is clearly relative to the organisation's size, for context NHS Lothian has an operating budget of c£2bn for 2023/24.</p> <p>High volumes of journal and reversing entries may lead to an increased risk of errors, fraud, and inefficiencies.</p>	<p>Improvement Point 1</p> <p>Automated systems are less prone to such mistakes but can have systemic errors if not set up correctly and incur considerable costs. A practical, low-cost improvement suggestion is to ensure regular focused training sessions for relevant individuals for completing journals are provided. This not only improves expertise but also provides assurance that the expected processes have been clearly communicated and understood.</p>	<p>This finding has attracted an 'Improvement Point' as opposed to a formal recommendation, and as such does not require a management response unless you wish to supply one.</p>

Detailed findings & action plan

3.1	Advisory	Missed cost-saving opportunities, or misallocation of resources, leading to increased operational costs.
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Finding and implication

From a comprehensive analysis of a manual journals download spanning from 1st April 2023 to 28th September 2023, we identified the total value of journals as £4,538.5 million across 4,393 entries. Notably, entries recorded as journals amounted to £2,283.9 million. The two pie charts below visually depict the distribution of values and counts of journals among Historic, Journal and Reversing entries.

For clarification.

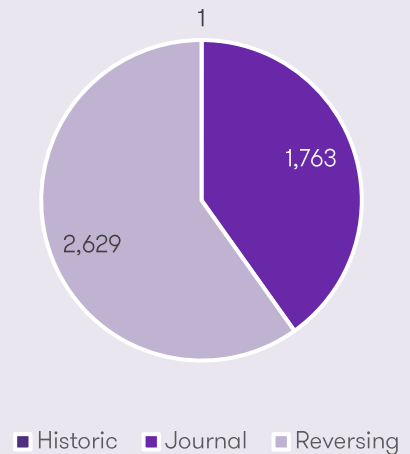
- Journal Entries record current financial transactions, crucial for maintaining accurate and up-to-date accounting records.
- Reversing Entries, reverse prior accruals at the start of new accounting periods to simplify processes; part of the current cycle.
- Historic Entries archive past transactions for historical reference, compliance, audit trails; not affecting current financial position or reporting.

Overall, there is a large number of journal entries which may indicate excessive manual interventions. High volumes of journals and reversing journals can increase the risk of errors, fraud, and operational inefficiencies.

Journal Types by Value



Journal Types by Count



Detailed findings & action plan

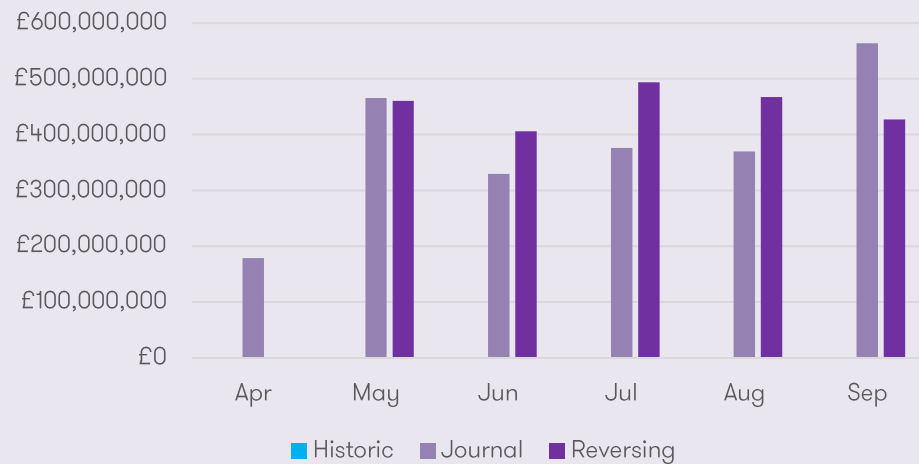
3.2	Advisory	Missed cost-saving opportunities, or misallocation of resources, leading to increased operational costs.
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Finding and implication

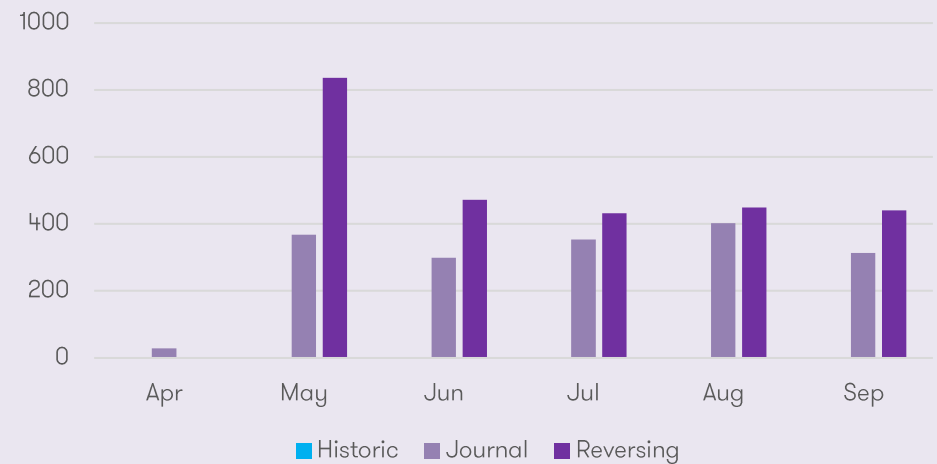
We examined the journals data for the months of April through September. The number of reversing journals shows fluctuations across the months, with May having the highest count at 836. We were informed by the Financial Accountant that this was expected and was caused by the 2022 ledger closing at the end of April, this aligns with our expectations and standard accounting practice. While the number of reversing journals fluctuates, the monetary values associated with these journals seem relatively consistent across the months, with the highest value of £493.8 million occurring in July. This suggests that the financial impact of the reversing journals remains within a reasonable range, which is positive.

Overall, no significant concerns arise from the analysis.

Journal Entries by Month (Value)



Journal Entries by Month (Count)



Detailed findings & action plan

3.2	Advisory	Missed cost-saving opportunities, or misallocation of resources, leading to increased operational costs.
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Finding and implication	Improvement recommendation	Management response, including actions
<p><u>High volume of 'PAYROLL CORRECTION.'</u> Journals</p> <p>In our analysis of journal entries, we identified a substantial volume of entries under the heading 'PAYROLL CORRECTION.' which due to the volume could be reducing efficiencies.</p> <p>Discussions with NHS Lothian Management Accountants identified this is due to difficulties getting cost centre changes through eESS (Electronic Staff Record System). Consequently, the management accounting team is tasked with rectifying coding errors through journal entries.</p> <p>To address this concern, a recent meeting with the Head of HR Management Info Systems was convened. The discussion centred on implementing templates for bulk changes to streamline the process, facilitating smoother cost centre amendments for Management accounts. It is expected that these measures will curtail the number of payroll correction journals in the future.</p>	<p>Improvement Point 2</p> <p>Monitor the effectiveness of implementing templates for bulk changes to reduce payroll correction journals.</p>	<p>This finding has attracted an 'Improvement Point' as opposed to a formal recommendation, and as such does not require a management response unless you wish to supply one.</p>
<p><u>High volume of 'CODING CORRECTION.'</u> Journals</p> <p>Analysis of journal categories revealed that 'CORRECTION CODING' journals, despite representing a significant proportion of the total journal entries (27.0%), make up 0.92% of the value of journals.</p> <p>The total value of 'CORRECTION CODING' journals was £21.1m, with the average value of a journal being £79.5k. This suggests frequent adjustments but with a moderate financial impact.</p> <p>From an efficiency standpoint, between 1 April 2023 and 28 September 2023, a total of 741 journals were categorised as either 'PAYROLL CORRECTION' or 'CORRECTION CODING'. Using an estimate of 5 minutes per journal, this equates to approximately 62 hours spent on these entries during the specified period.</p>	<p>Improvement Point 3</p> <p>Identify and evaluate the root causes leading to the need for 'CORRECTION CODING' journal entries. Additionally, consider introducing a de minimus threshold for corrections, where any adjustments below a certain value are not corrected.</p>	<p>This finding has attracted an 'Improvement Point' as opposed to a formal recommendation, and as such does not require a management response unless you wish to supply one.</p>

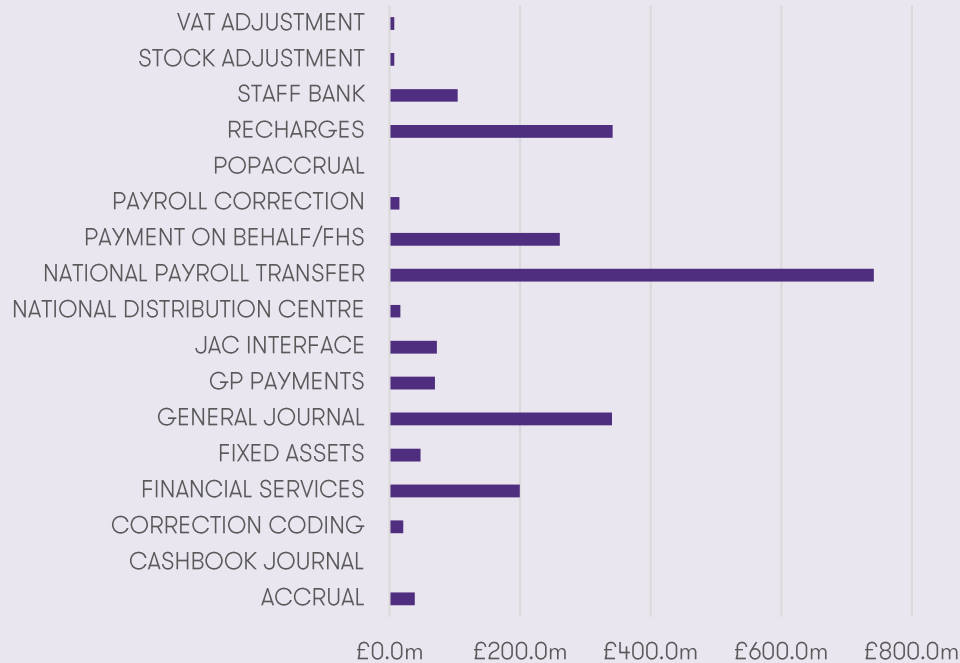
Detailed findings & action plan

3.2	Advisory	Missed cost-saving opportunities, or misallocation of resources, leading to increased operational costs.
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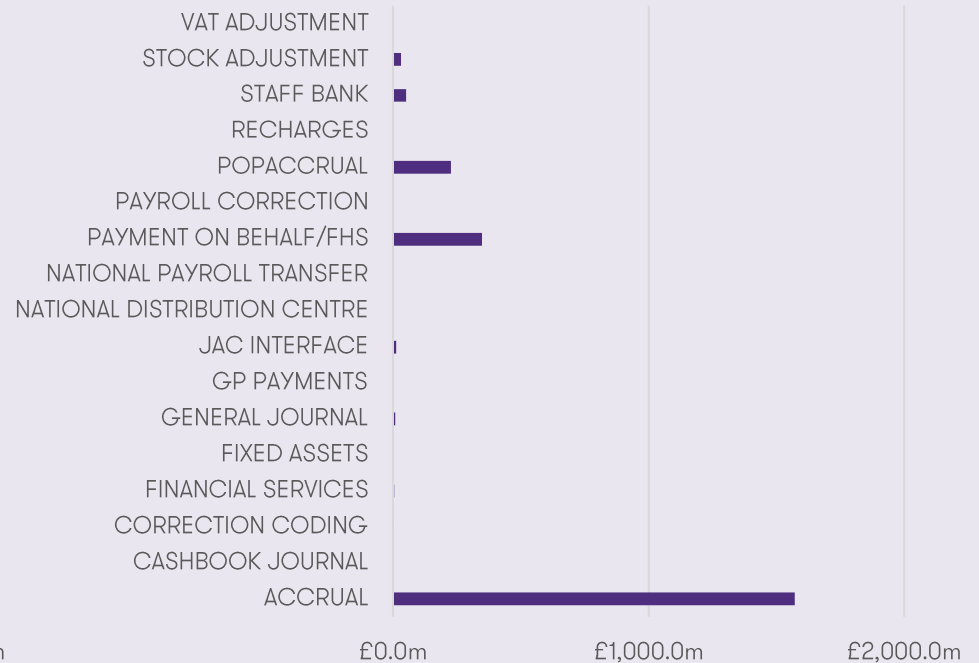
Finding and implication

Analysis of journal entries by categories revealed that 'PAYROLL CORRECTION' and 'CORRECTION CODING' collectively constituted 42.0% of journals, 741 entries (excluding reversing journal entries). However, their combined value was £36.1m, accounting for only 1.6% of the total journal value. The average value of the 'CORRECTION CODING' journals was £79.5k. The average value of a 'PAYROLL CORRECTION' journal is £31.6k. Even though 'PAYROLL CORRECTION' and 'CORRECTION CODING' account for 42.0% of all journals, their monetary impact remains relatively modest. Further analysis identified 18 of 741 journals were under £10. Improvements in initial coding and payroll processing could improve efficiency.

Value of Journals by Category



Value of Reversing Journals by Category



Detailed findings & action plan

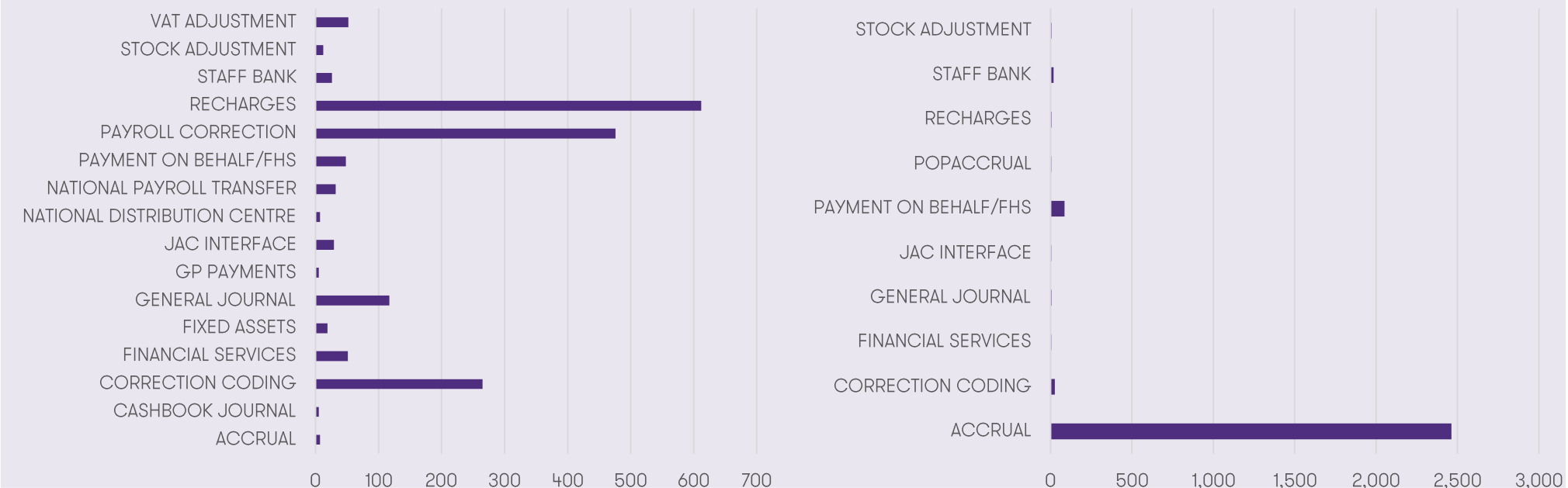
3.2	Advisory	Missed cost-saving opportunities, or misallocation of resources, leading to increased operational costs.
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Finding and implication

Our analysis of journal categories identified in "Journals" that the number of journals by category types was mainly consistent with standard usage patterns. We did identify a high number of Payroll Correction and Correction Coding journals as reported on the previous page. For Reversing Journals, the category "Accrual" records the majority of the 2,463 entries with 2,269 counts. This number of reversing journals indicates potentially intricate accounting practices or the need for frequent adjustments to ensure an accurate financial representation. Another contributor to the number of reversing journals may be the existence of significant timing differences in revenue recognition or expense accruals.

Number of Journals by Category

Number of Reversing Journals by Category



Detailed findings & action plan

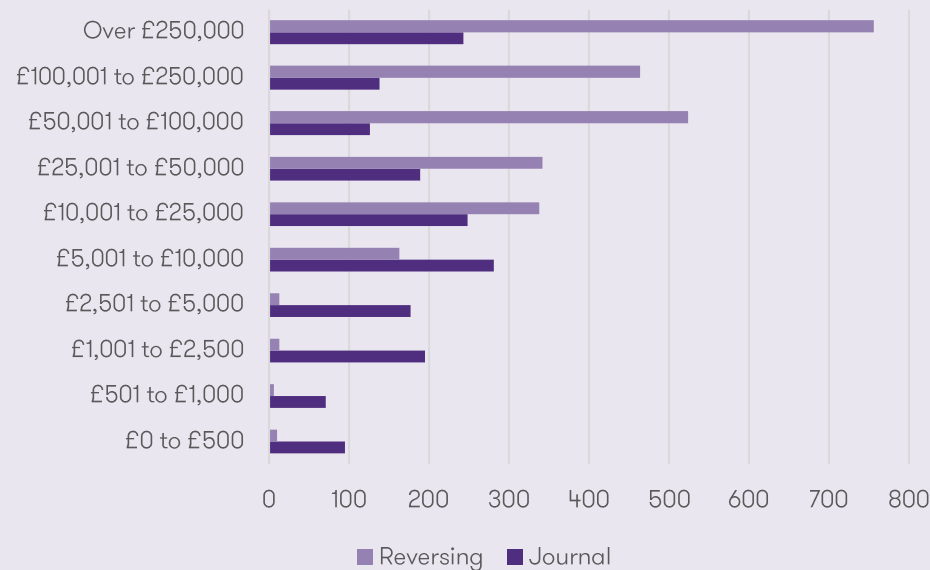
3.3	Advisory	Missed cost-saving opportunities, or misallocation of resources, leading to increased operational costs.
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Finding and implication

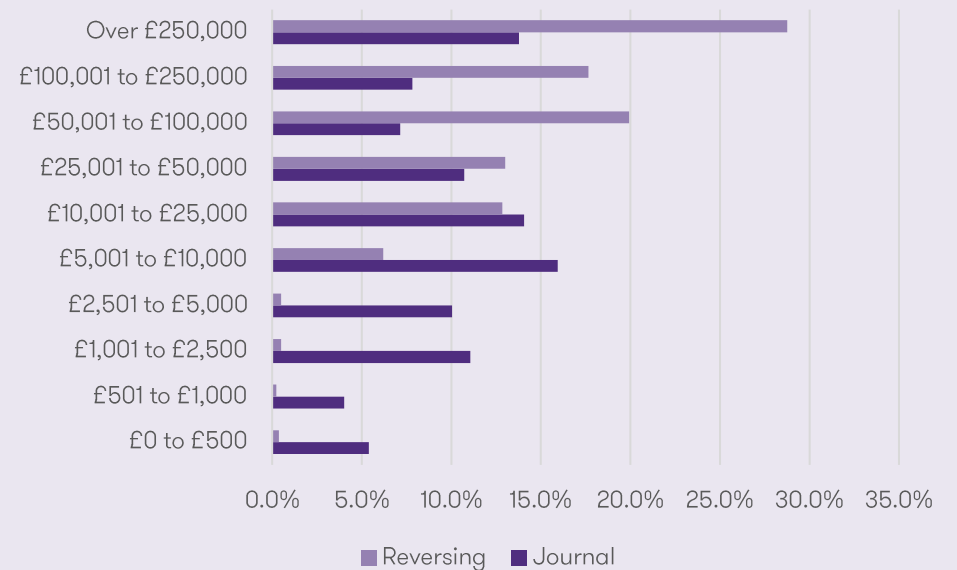
In our stratification analysis of journal entries into value bandings, we made the following observations. The majority of “Journal”, approximately 51.1%, fall within the four centre ranges covering £1,001 to £25,000 which is consistent with expected business operations. The percentage of reversing journals notably increases as the journal amount rises. Specifically, reversing journals over £250,000 have a high reversing rate, showing the most significant percentage at 28.8%. It is commonplace for larger journals to undergo adjustments.

Overall, no significant concerns arise from the analysis.

Stratification of Journals by Value



Stratification of Journals by Percentage



Detailed findings & action plan

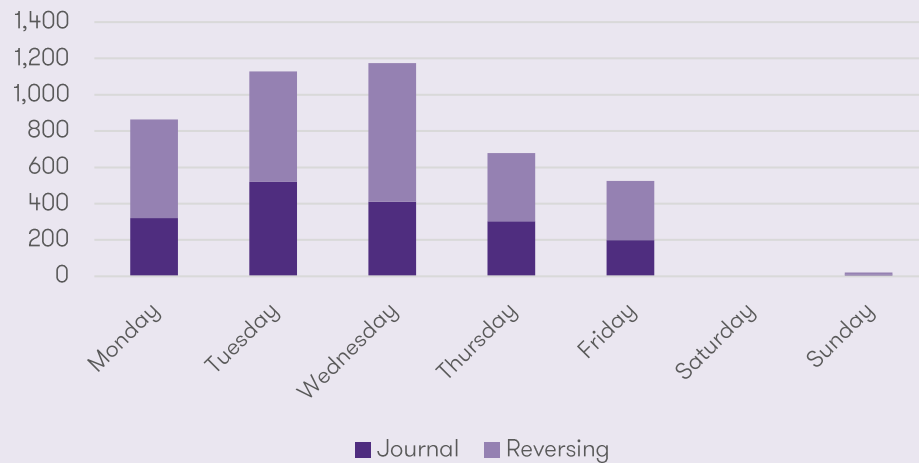
3.4	Advisory	Missed cost-saving opportunities, or misallocation of resources, leading to increased operational costs.
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Finding and implication

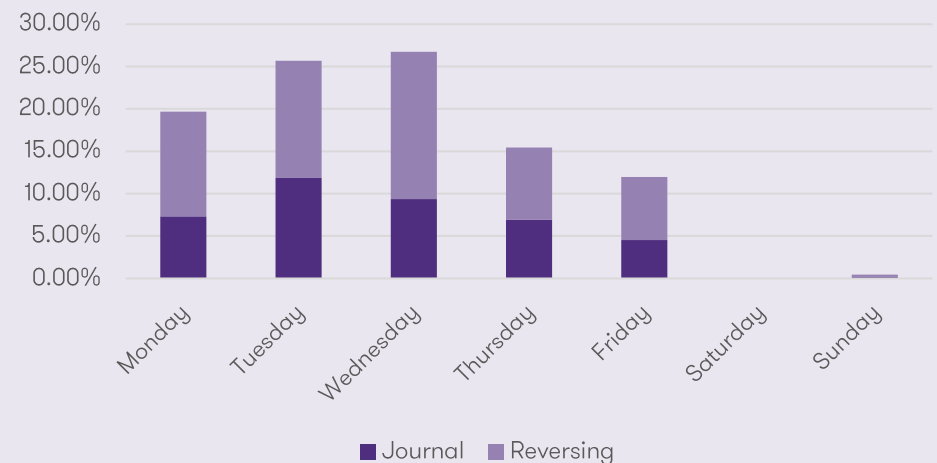
Our analysis of the day of week journals were posted reveals that “Journal” entries were predominantly posted between Monday and Wednesday, with Tuesday recording the highest. The weekend shows minimal activity. “Reversing” journals, mainly accruals, are notable, especially on Wednesdays.

Overall, weekday distribution appears typical.

Number of Journals by Day



Percentage of Journals by Day



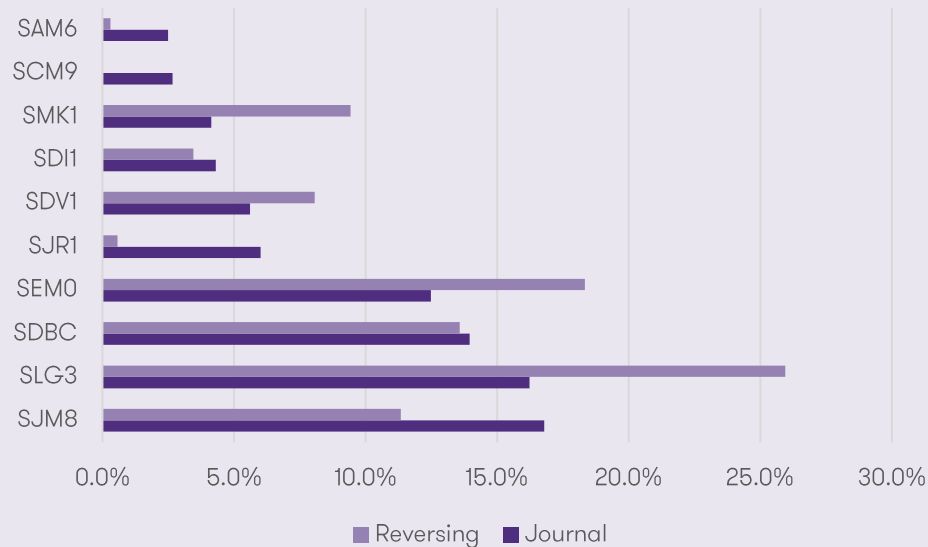
Detailed findings & action plan

3.5	Advisory	Missed cost-saving opportunities, or misallocation of resources, leading to increased operational costs.
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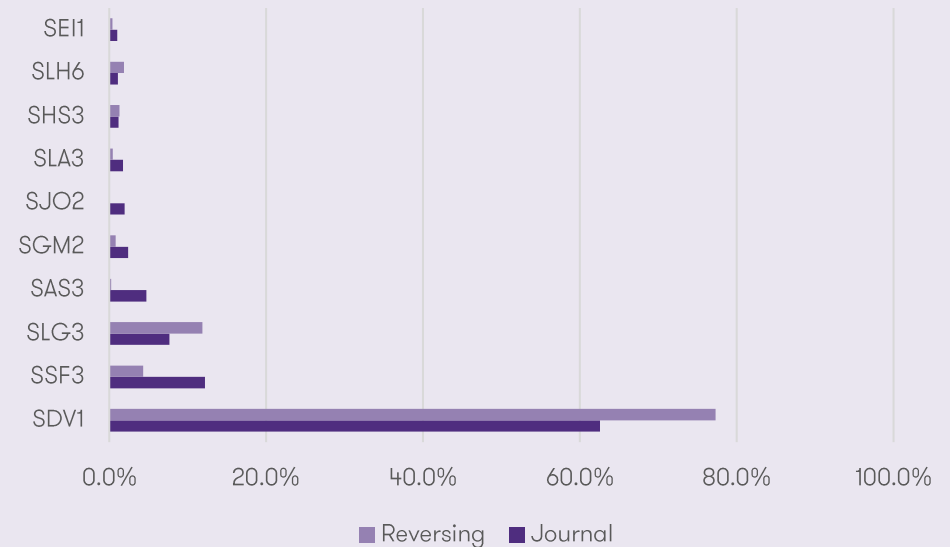
Finding and implication

For journal authorisation there is a relatively concentrated distribution. For “Journals” there were 20 authorisers with SDV1 and SSF3 responsible for 62.6% and 12.2% respectively. For “Reversing”, SDV1 authorised a notably high percentage at 77.3%. Of the 21 active authorisers many contributed negligibly. The centralisation of authorising power could pose an internal control risk, as over-reliance on one individual can heighten the risk of oversight or fraud. Management has informed us that they do not wish to increase the number of authorising staff, as this process is managed by the Control Team. They have indicated that adding further authorisers could introduce new risks. Following our discussions with management, we have concluded that no significant concerns arise from this analysis.

Percentage of Journal Types by Preparer (Top 10)



Percentage of Journal Types by Authoriser (Top 10)



Appendices

Appendix 1: Staff involved and documents reviewed



Staff involved

- Olga Notman, Head of Financial Control
- Simon Fawcett, Financial Accountant
- Margaret Wolfenden, Management Accountant



Documents reviewed

- Financial Operating Procedures
- Journals Export – 1st April 2023 – 28th September 2023



Appendix 2:

Our assurance levels

The table below shows the levels of assurance we provide and guidelines for how these are arrived at. We always exercise professional judgement in determining assignment assurance levels, reflective of the circumstances of each individual assignment.

Rating*	Description
Significant Assurance	<p>The Board can take reasonable assurance that the system(s) of control achieves or will achieve the control objective. There may be an insignificant amount of residual risk or none at all.</p> <p>There is little evidence of system failure and the system appears to be robust and sustainable. The controls adequately mitigate the risk, or weaknesses are only minor (for instance a low number of findings which are all rated as 'low' or no findings)</p>
Moderate Assurance	<p>The Board can take reasonable assurance that controls upon which the organisation relies to achieve the control objective are in the main suitably designed and effectively applied. There remains a moderate amount of residual risk.</p> <p>In most respects the "purpose" is being achieved. There are some areas where further action is required, and the residual risk is greater than "insignificant".</p> <p>The controls are largely effective and in most respects achieve their purpose with a limited number of findings which require management action (for instance a mix of 'medium' findings and 'low' findings)</p>
Limited Assurance	<p>The Board can take some assurance from the systems of control in place to achieve the control objective, but there remains a significant amount of residual risk which requires action to be taken.</p> <p>This may be used when:</p> <ul style="list-style-type: none"> • There are known material weaknesses in key control areas. • It is known that there will have to be changes that are relevant to the control objective (e.g. due to a change in the law) and the impact has not been assessed and planned for. <p>The controls are deficient in some aspects and require management action (for instance one 'high' finding and a number of other lower rated findings)</p>
No assurance	<p>The Board cannot take any assurance from the audit findings. There remains a significant amount of residual risk.</p> <p>The controls are not adequately designed and / or operating effectively and immediate management action is required as there remains a significant amount of residual risk (for instance a number of HIGH rated recommendations)</p>

Appendix 2:

Our recommendation ratings

The table below describes how we grade our audit recommendations based on risks:

Rating	Description	Possible features
High	Findings that are fundamental to the management of risk in the business area, representing a weakness in the design or application of activities or control that requires the immediate attention of management	<ul style="list-style-type: none"> • Key activity or control not designed or operating effectively • Potential for fraud identified • Non-compliance with key procedures/standards • Non-compliance with regulation
Medium	Findings that are important to the management of risk in the business area, representing a moderate weakness in the design or application of activities or control that requires the immediate attention of management	<ul style="list-style-type: none"> • Important activity or control not designed or operating effectively • Impact is contained within the department and compensating controls would detect errors • Possibility for fraud exists • Control failures identified but not in key controls • Non-compliance with procedures/standards (but not resulting in key control failure)
Low	Findings that identify non-compliance with established procedures, or which identify changes that could improve the efficiency and/or effectiveness of the activity or control but which are not vital to the management of risk in the business area.	<ul style="list-style-type: none"> • Minor control design or operational weakness • Minor non-compliance with procedures/standards
Improvement	Items requiring no action but which may be of interest to management or which represent best practice advice	<ul style="list-style-type: none"> • Information for management • Control operating but not necessarily in accordance with best practice

