SOUTH LANARKSHIRE COUNCIL

Report

Report to:	**Risk and Audit Scrutiny Forum**
Date of Meeting:	**16 December 2010**
Report by:	**Chief Executive**

Subject:	**Innovative Internal Audit - Continuous Controls Monitoring**

1. Purpose of Report

1.1. The purpose of the report is to:-

♦ Report on progress with a planned project looking at new ways of monitoring system controls.

2. Recommendation(s)

2.1. The Forum is asked to approve the following recommendation(s):-

(1) that progress is noted.

3. Background

3.1. In 2009, representatives from the Internal Audit and IT Services from South Lanarkshire Council attended network and awareness raising seminars organised by Ernst Young, one of the leading private sector accountancy companies to share best practice and learn about Continuous Controls Monitoring (CCM).

3.2. The aim of CCM is to present trends and exceptions arising from analysis of financial data. Exceptions can be used to direct further audit investigation. Assurance can be gained if there are few exceptions or if investigation of exceptions results in corrections or sound explanations. An example of resultant assurance reporting is included in Appendix One.

3.3. In the long term, services should take ownership of controls monitoring. Some of this is already in place for example volume and value of payroll corrections and duplicate creditors payments. Another common CCM control would be the volume and value of debtor accounts which remain unpaid after a specific period for example one year.

3.4. Implementation of CCM is time intensive and some solutions can be expensive as they require dedicated software. As the Internal Audit Service already has sophisticated data analysis software which could be developed for CCM, a project was included in the 2010/11 Internal Audit Plan. The objective of this assignment is to establish whether or not there is a business case for CCM. A copy of the full remit is included in Appendix Two.

4.   Progress with planned activity

4.1.   Standard audit test programmes for each of the main financial systems such as Debtors, Accounts Payable and General Ledger have been examined. Joint working with South Ayrshire Council has identified which system controls are suited to CCM and which will need to continue to be audited in the traditional manner. Examples of controls which have been selected for CCM development include duplicate supplier payments, supplier spend, employee cheque payments, volume and value of journals. Examples of controls which will continue to be manually examined include review of procedures and manual authorisations.

4.2.   SLC is concentrating on the development of CCM for general ledger (GL) controls. Significant volumes of actual and budget data have already been downloaded from the ledger and analysed using the IDEA audit tool. For example, the value and quantity of adjustments between the ledger and the final committee reports can now be routinely quantified with large or frequent items explored and explained. This provides assurance over the completeness and accuracy of financial information being reported to elected members. Unusual trends and patterns can also be investigated and more efficient treatment could be suggested. For example if there are significant regular adjustments which simply relate to timing issues then a review of expenditure phasing may be appropriate.

4.3.   The data which has been downloaded so far is being used to identify patterns which may require audit investigation. It is anticipated that the following GL indicators will form the core of CCM for the general ledger system.
*   High volume and high value budget virements
*   Exceptional variances between actual and budget, for example all variances over 15%
*   Account codes with spend but no budgets
*   Volume and value of manual journals
*   Trends in suspense account balances at period ends
*   Value and volume of feeder transactions
*   Cost centre additions, deletions and changes.

4.4.   These areas are important as most are already recognised as high risk. For example, journals are substitutes for direct accounting entries and as such are more open to risk of fraud, error and inefficiency. Too many cost centre changes can allow increased costs to be booked where no budget exists. New cost centres could also fall outside the hierarchy used for budgetary control. These are therefore crucial controls which need to be monitored and tested.

4.5.   Data collected to date has helped planned audit work already in other areas. Expenditure on taxis and consultants is already analysed by period and by supplier which will greatly reduce the time spent on these separate audit assignments. Procurement through use of purchase cards is also now more easily identified as are Housing Revenue accounting entries and chargeable income.

4.6.   CCM analysis will be summarised to report trends and exceptions in a dashboard style of report rather than a narrative report at present. This is still under development but an example of a controls dashboard is included in Appendix Three.

5. Progress in other areas

5.1. Understanding CCM has allowed for a number of "quick wins" to be developed in other system areas to help services better control their income and expenditure. These are listed in Table One below.

Table One – CCM quick wins

Control being monitored	Benefits	Outcome to date
Quantity and value of petty cash top ups (extract from Accounts Payable)	Shows total value of spend through all accounts Allows selection of high risk accounts for audit	Shows need for reconciliation which is currently work in progress. High value of spending indicates VAT error risk.
Frequency of bankings by schools (Extract from Income management)	Identifies risk of high cash holdings in schools	Services contacting schools and improving implementation of procedures

6. Employee Implications

6.1. Initial development of CCM is time intensive. To date only 50 days have been spent but most work will take place in the last three months of the financial year. Specific skills are needed to operate the IDEA analysis tool and a very good working knowledge of the Council's financial systems and controls is needed. As a result only one auditor and one technician are working in this area at present.

6.2. Time is already being saved on assignments which can now use information arising from CCM analysis (refer paragraph 4.5). It is hoped that the use of dashboards will reduce the size of final audit assurance reports. If CCM is used by services, Internal Audit will be able to rely on their exception reporting without the need to do significant additional audit testing.

7. Financial Implications

7.1. CCM usually operates using dedicated software and data servers. Indicative costs in 2009 were between £30,000 and £40,000 so this option was not pursued. The current project will determine whether or not there is a business case to reconsider this option rather than continuing to use audit analysis tools and size intensive storage on shared or separate hard drives.

8. Other Implications

8.1. There are clearly risks that CCM may not prove to be value for money or that services may not be prepared to take ownership of monitoring once established. The project has been designed to produce user friendly dashboards which will hopefully be convincing. Should services fail to agree then the audit service will need to revert back to more traditional forms of audit which may cost more in the longer term. Monitoring of control continues to be a management, rather than audit, responsibility.

8.2. The CCM work to date has downloaded general ledger entries into a much more flexible format. This format may also be of use to external audit when selecting samples for their year end audit work.

9. Equality Impact Assessment and Consultation Arrangements

9.1. There is no requirement to conduct equality impact assessments.

9.2. South Ayrshire and Financial Service Managers are being consulted during development of CCM.

Archie Strang
Chief Executive

25 November 2010

Link(s) to Council Values and Objectives
♦ Accountable, effective and efficient

Previous References
♦ None

List of Background Papers
♦ CCM working files

Contact for Further Information
If you would like to inspect the background papers or want further information, please contact:-
Joan Allan, Risk and Audit Manager
Ext: 5957 (Tel: 01698 455957)
E-mail: joan.allan@southlanarkshire.gov.uk

Example of Summary Assurance Reporting resulting from CCM   **Appendix One**

Creditors

Continuous audit of the creditors system for the period XXX to YYY 2010 gave rise to AA queries, as outlined in the table below.

Type of query	Number of exceptions	Explanations
Duplicate payments	BB	£DDDD identified and subsequently recovered during the period.
Payments over £30k	CC	All payments were fully supported by valid orders, goods received notes and invoices

No Creditors queries identified material systemic failings. Assurance level: **Good**

Payroll

Continuous audit of the payroll system for the period XXX to YYY 2010 gave rise to AA queries, as outlined in the table below.

Type of query	Number	Explanations
Inactive employees	BB	No reconciliation is being undertaken between HR and Payroll systems. Rectification action agreed by local management.
Cheque payments	CC	New employees not being notified to payroll in time for normal payrun. On going issue now escalated to Directors to promote procedural compliance.

Payroll queries identify on going issues but these not material in value. Assurance level: **Adequate**

Audit Objective
The objective of the current assignment is to investigate whether or not there is a business case to use continuous controls monitoring as a core ingredient of future annual internal audit plan and to produce some preliminary exception indicators.
Audit Scope
The assignment will involve:
Stage 1
i)	classification of control tests from CIPFA and external audit programmes into those which lend themselves to quick win CCM, those for longer term development, those already in service ownership where assurance should be provided to audit and those best tested through traditional methods. This should include draft specification of possible exception indicators.

Stage 2
ii)	Review of existing FMS report extracts to assess usefulness

Stage 3
iii)	Preparation of technical instructions, where these do not already exist, to output data to Idea for top level review
iv)	Review of top level value and volume transactional data to identify high risk and priority work areas
v)	Pilot an initial set of system downloads for analysis. The number of systems reviewed will depend on time available.
vi)	From pilot downloads identify potential "quick win" and "future development" exception indicators. (Early work is concentrating on expenditure variances over an agreed threshold, supplier payments with varying ledger codes, duplicate creditor payments etc.)

Stage 4
vii)	Comparison of pilot exception indicators to those identified from review of standard audit programmes (see i) above) and define a final set of indicators for reporting during 2010/11
viii)	Design of a dashboard presentation for exceptions reporting which can be shared with local management and clients

Stage 5
ix)	Definition of a timetable for regular data download and allocation of duties
x)	Extract of selected exception indicators from Q3 and Q4 relevant downloads
xi)	Decision regarding audit or service investigation of variances
xii)	Design of a reporting format for capturing investigation results
xiii)	Presentation of results to local management, services and Idea User Group
xiv)	Preparation of a business case for future development of CCM

Sample: All data will extracted from the 2010/11 financial year. Choice of systems or indicators for development and investigation during the year will depend on the time available.

Major Risks: Inefficiencies or gaps in internal control systems.

Example of a Controls Dashboard   **Appendix Three**

Exception Distribution by Monitor Name

TOTAL EXCEPTIONS: 3536 (Tue, Jul 01, 2003 - Fri, Jun 18, 2004)
REPORTING TIME: Friday, June 18, 2004 1:32:46 AM

<<	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	TOTAL		
0	0	0	0	57	145	87	247	148	189	26	0	0	899		PO Splitting at $25K
44	16	38	69	115	104	131	81	89	22	1	0	0	666		Ducplicate invoices paid
0	0	0	3	129	102	81	71	75	79	18	0	0	558		PO Terms shorter than Vendor Master
57	1	0	289	16	8	11	4	9	2	1	0	0	341		Vendors with Pay Immediately terms
0	0	0	2	68	38	37	38	27	30	6	0	0	246		PO Terms shorter than Purchasing Orgs
0	0	0	0	37	44	32	28	20	22	5	0	0	188		Large AP Upload with Short Terms
0	0	0	0	22	31	32	14	14	33	4	0	0	150		One time vendor compliance checking
0	0	0	0	9	7	14	17	25	27	12	1	0	112		Invoice Requiring PO
0	0	0	3	20	19	20	17	11	15	3	0	0	108		Large AP Upload
0	0	0	0	6	6	6	9	14	49	5	0	0	95		Credit Memo without PO
120	3	3	59	4	8	6	7	1	0	0	82	0	173		Others