

AUDIT AND RISK COMMITTEE

11 June 2013

PAYROLL INTERNAL CONTROLS REVIEW

Report of the Interim Strategic Director for Resources

STRATEGIC AIM:	All
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1. PURPOSE OF THE REPORT

1.1 At the Full Council meeting on 22 April 2013, the Chief Executive presented a report which explained that over the last four years the Council had made a series of under and overpayments in error to staff. The errors made arise from deficiencies in the internal control system (a glossary of terms used in this report is attached at Appendix B). The purpose of this report is to explain:

- how the errors came to light;
- the approach to the internal investigation carried out;
- why the errors happened and why they persisted over time;
- why the errors were not identified by Internal Audit;
- the relationship between the current matters and the previous Internal Audit report; and
- action taken by management to fix the problems.

2. RECOMMENDATIONS

2.1 **That the Committee notes the actions taken to address internal control matters and that a report on the independent review of Internal audit will be presented to the September meeting.**

3. REASONS FOR THE RECOMMENDATIONS

3.1 To provide the Committee with assurance that issues arising from the Payroll audit have been dealt with.

4. UPDATED POSITION

4.1 How the errors came to light

Routine queries regularly come in to the payroll team by employees seeking clarity and confirmation regarding their pay, e.g. pension benefit, payment for overtime, sick pay deductions and tax codes. None of the queries raised has ever suggested there was a systemic problem with amounts being paid.

In November, the Council employed a temporary member of staff to help operate the payroll system. The new staff member had little experience of the Council's terms and conditions so prior to processing claims began to ask questions about whether staff were entitled to certain enhancements. These checks highlighted some concerns but it was not known at this stage how widespread the problems were.

At the same time, during the 3rd quarter of 2012/13 the Payroll and HR teams identified similar problems whilst completing a number of projects, for example:

- Discrepancies in Sunday enhancements for Home Care and Community Support workers and weekend payments for casual registrars were identified during reviews of contracts being undertaken as part of a service review;
- The Council had also recently identified a small group of staff in Adult Learning had been overpaid for their working pattern. Overtime rates for extra hours worked Monday to Saturday had been paid at plain time instead of time and a half (full time employees);
- Routine work of the HR team had also identified that Agresso was not set up to alert HR and payroll of pending changes to an employee's pay record, e.g. midyear increments, end of pay protection. Investigation of these issues identified that during the implementation of Agresso, such processes were not part of the system development and functionality and therefore an obvious process was being 'missed'.

In early December, the Head of Business Support (People) raised the above matters with the Interim Strategic Director for Resources and in consultation with the Chief Executive, a decision was made to undertake a 100% check of all payroll records. Both officers were in agreement that without undertaking a full check, it would be difficult to gain assurance that all matters had been identified.

4.2 The internal investigation approach – the payroll check

The purpose of the check was to identify any discrepancies in pay or enhancements that were not in accordance with individuals' contracts of employment or terms and conditions. The terms and conditions for most employees in the Council are governed by the National Joint Council (Green Book) with some groups of staff on Youth Worker (Pink Book) conditions and Adult learning staff on a local agreement with University and College Union (UCU). The check was undertaken in two phases:

- (a) The HR team assessed the employee's pay record against:
- their contract of employment in order to verify terms and conditions appropriate to the role and grade, e.g. Overtime;
 - the record held in Agresso;
 - payslips – basic pay, salary protection, honorarium, market supplement;
 - the pay structure – verifying that increments have been appropriately paid e.g. Annual increment, career grade progression; and
 - schedules of overtime and weekend enhancements.

- (b) Where a discrepancy was identified, the Payroll team further assessed the pay record in order to determine the value of the under or overpayment. Records were checked back to 2009 when Agresso was implemented (NB: it was identified that the Agresso system was set up incorrectly to pay overtime rates at double time hence facilitated the overpayments).

The check also focused on existing employees only. It was decided that a decision regarding extending the check to staff who have left the Council would be deferred until the outcome of the initial review.

The results of the payroll check are not repeated in this report but are detailed in Council report 115/2013.

4.3 Why errors happened and how they persisted over time?

Errors occur for one of two reasons, firstly, systems and processes are poorly designed or secondly, those individuals exercising controls over operations do not do so as intended. In the case of the over and under payments, the errors occurred for both reasons. The key weaknesses are set out below.

4.3.1 Misunderstanding of Term & Conditions

As identified in 4.2, the Council's conditions of service are governed by national agreements – most staff being covered by the National Joint Conditions (Green Book). These, for example, relate to the pay spine, and rules for overtime and enhancements and have been in place for many years.

The rules regarding Sunday enhancements reducing to 'time and a half' after Scale Point (SCP11) are very clear as is the rule regarding no overtime payments for employees over SCP 28. In 2010 the Council amended the Green Book provisions for sick pay through individual negotiation with individuals and has from time to time transferred staff in from other authorities – such staff transfer, under the "Transfer of Undertakings (Protection of Employment) Regulations" (TUPE) regulations, on their conditions of service and these may not on all occasions therefore match RCC conditions. These are the only circumstances where any variance from the Green Book would be in place.

However, it is evident from feedback from managers that their understanding of the Green Book and the content of employee's contractual terms is not clear. Furthermore, the detailed knowledge was not held in the Payroll team who therefore did not question the basis of payments when claim forms were submitted.

The lack of understanding can be further demonstrated by adverts being written by managers including provision for weekend enhancements but this was not replicated in contracts – which actually specified that enhancements were not payable. Where adverts did include reference to enhancements, it may again help explain why staff were under the impression that this was allowable.

The Council can find no evidence of guidance or instruction being issued to managers and it would seem that, in the absence of clarity, an element of 'personal interpretation' has applied which has become the norm and set precedent contrary to the Green Book. Over time, knowledge has been diluted with a further apparent disconnect between managers, HR and payroll with no clear accountability for ensuring such issues are appropriately managed and monitored.

4.3.2 Agresso issues

The way in which Payroll accounting systems are set up can help to mitigate risks associated with running the payroll. It is usual for systems to include validation and other checks which prevent 'errors' from occurring or provide reporting 'tools' which enable checking of data input.

The way in which Agresso has been set up does help mitigate some risks but there are gaps. For example:

- The registration of employee information on Agresso does not cover their entitlements under terms and conditions e.g. as it stands you cannot restrict an officer not entitled to overtime payments from receiving them if a claim is processed. Ideally, the system would be designed to prevent such a payment from occurring;
- The Sunday enhancement is set to pay at double time when contractual conditions only allow for 'time and a half';
- Agresso is only as good as the data put onto the system – in some instances not all relevant data is loaded into the system, e.g. dates when an increment is due, and the system still permits that record to become 'live'. In this example it would mean that an increment would be missed unless there is manual intervention; and
- The management reporting available to the Council is at present limited. Whilst reports in relation to new starters and leavers for example are available so that data input can be checked, reports on 'contract changes' are not routinely available.

4.3.3 Authorisation controls exist but did not work

All variable pay adjustments, e.g. overtime, are paid on claims signed by employees and authorised by line managers. The authorisation of claims is a standard payroll control built in to all systems. However, it is predicated on managers and employees understanding the hours worked by employees and their entitlement under terms and conditions.

As noted in 4.3.1, some managers made incorrect assumptions about the content of contracts and where advice was sought from Payroll and / or Human Resources inconsistent advice was given. In these cases, manager authorisation provided assurance that the hours worked were correct but no assurance as to whether the rates being claimed were valid.

4.3.4 Payroll secondary checks were limited

Timesheets/overtime claims are checked by Payroll. The check focuses on whether claims have been signed by employees and authorised by

managers. A secondary check (after claims have been input to Agresso) is performed to ensure claims received have been input correctly.

The secondary checks do not involve agreeing the claim basis back to source documentation, e.g. contracts, or a reference guide which sets out the entitlements of different groups of staff. Payroll staff relied on manager authorisation which, as noted above, was weak.

Whilst the weaknesses above are acknowledged, there have been questions raised as to whether the errors should have been picked up via other means, e.g. through budget monitoring. This did not happen because the variable pay (overtime) element of the budget is based on historical cost so the error was effectively built in to the budget against which managers were monitoring. Moreover, the amounts in many cases were relatively small and would go undetected through normal monthly monitoring.

4.4 **Role of Internal Audit**

The role of Internal Audit is to provide assurance to management in relation to the adequacy of the system of internal control. Internal controls are the processes, procedures and actions the Council takes to achieve an objective or manage risks. In providing their opinion on an individual system e.g. payroll, Internal audit should assess:

- the design of the internal control system – is the way the system is designed adequate to mitigate key risks? This evaluation is undertaken in conjunction with management and involves documenting processes, identifying potential risks and assessing how they are mitigated;
- whether internal controls are operating as designed – auditors should design tests around the internal controls that exist and check whether controls are working as designed.

Internal audit will then conclude as to whether internal control systems are robust and give an opinion. Where the opinion is not satisfactory, Internal audit will make recommendations which management will consider and implement where they are agreed.

In July 2012, the internal auditors concluded that the payroll system was 'unsound' – that there were significant weaknesses in the way the internal control system was designed and operated. The scope of the July 2012 audit is shown below.

The audit included an examination of the key controls to give assurance that:

- Payroll processes are performed efficiently;
- Payments and deductions are made in accordance with policies and legislation;
- Payments are made to genuine employees at the right time and for the right amount;
- Payments and deductions are properly recorded and authorised;
- Payments and deductions are accurately reflected in the main accounting system and the annual accounts; and
- Payroll and employee benefit data is protected from loss, damage or unauthorised access.

However, in arriving at that conclusion the Internal auditors did not unearth some of the problems that led to the payroll errors. Given the scope of the audit above, it would not be unreasonable to suggest that the auditors should have identified the issues. The reasons they did not are explained below:

- The auditors should assess the design of the system and comment on its effectiveness. The design evaluation did pick up problems but the evaluation was not comprehensive. It failed to identify for example that the internal control system was set up to allow officers on SCP 28 to be paid overtime when contractual conditions do not allow this.
- Audit tests on overtime payments were undertaken and auditors did complete tests as instructed but unfortunately the tests were not adequately designed – one of the key controls in the payroll system is manager authorisation of overtime claims. In order for auditors to assess the quality of authorisation (i.e. whether the authorisation control really works), they need to effectively check whether the payment is valid. The way they would normally do this is check back to the original contract as to whether a payment is allowed and at what rate. The auditors checked that claims were signed off and input correctly but they did not check as to whether the basis of payment was correct. If Internal Audit had gone back to source documents, e.g. contracts, they would have verified that payments were invalid and this would have called into question the integrity of the authorisation process.

In summary, the Internal audit process was flawed. Following the initial Council meeting, the Strategic Director for Resources raised the issue with the Welland Internal Audit Board and it was agreed that the Council would commission an independent review of the Internal Audit function. The terms of reference for this review are shown at Appendix A. To date, the Council received two quotations from interested parties and the Interim Strategic Director for Resources is in the process of evaluating them. It is envisaged that this review will be completed and reported to the September Audit and Risk Committee.

4.5 The relevance of the previous IA report

At the Full Council meetings, a question was raised along the lines of “Why have we got payroll errors now if we have fixed the payroll issues highlighted in the Internal Audit Report issued in July 2012?”

As explained above, the payroll audit did highlight problems – it concluded that systems were ‘unsound’ but the issues identified were not relevant to the underlying issues that caused the payroll overpayments. An analysis of the issues in that report and whether they relate to current matters is reported below:

Issues	Related?	Comments
Inappropriate levels of access to the Human Resources and Payroll modules within Agresso have been granted to specific employees. This has resulted in the removal of system access controls.	No	None of the over or underpayments arise from this matter. Access controls were tightened up following the audit.
Over-reliance has been placed on one member of staff to perform routine tasks that are not appropriate to the position held by this employee.	No	The staff member concerned is the Agresso administrator. He is employed to work full time on Agresso systems support. The Council does place reliance on him as the in-house expert. However, this officer is not routinely involved in payroll processing.
During testing a significant number of areas of concern were discovered with expenses submitted by employees. All expenses claims must be approved by the employees' line manager and errors have been processed following management approval.	No	The issue calls into question the quality of authorisation in relation to expenses not overtime or enhancements as managers have authorised expense claims when they should not.
During roll out of the electronic method of submitting expenses claims supplementary checks were being completed to ensure submitted expenses claims were appropriate. Due to a high level of compliance to prescribed processes, such accuracy checks were stopped during October 2011 approximately nine months after roll out. A number of the errors highlighted during sample testing occurred after these checks ceased.	No	The matter refers to expenses. It is unusual in any organisation that 100% checks are undertaken for cost reasons particularly where initial checks indicate a high level of compliance.
A number of employees have been setup as substitutes for their line managers; therefore these employees have the potential to approve their own expenses claims.	No	This issue could not apply to overtime claims as they are manually submitted and approved.
A small number of employees have received training assistance without signing a Training Agreement. This could result in financial loss to the Council if the employees leave as without a signed contract they are not legally bound to repay the fees incurred.	No	None of the overpayment matters relate to recovery of training costs.
Testing of the personnel files of a recent starters and leavers found that a significant number were missing the required documentation either authorising the appointment, or detailing the leaving process. Of those that were on file a number had not been fully completed.	No	If information was missing off the Agresso electronic employee record then this may cause under or overpayments but the audit finding relates to paper files. Incomplete/erroneous electronic records were not referred to.
The Council does not have an Establishment List detailing all posts and salary grades.	No	There is a procedure in place for the approval of new posts. All posts are approved irrespective of whether the Council has an Establishment List.

4.6 Fixing the problems

As noted above, errors occur as a result of systems being poorly designed or controls being poorly exercised. Following the completion of the pay audit, a workshop with processing staff in payroll and HR was undertaken. The purpose of this workshop was to document end to end payroll processes and to identify where there are weaknesses. Subsequent to the workshop, payroll and HR staff have developed a new control model, the 'To Be' Model which addresses the identified weaknesses. Some improvements have already been put in place, and others are being addressed because they require Agresso changes.

The weaknesses and actions arising from this meeting are documented below:

Weakness	Proposed fix	Status
Lack of procedures governing payroll operations	Payroll procedures are being developed around the 'To Be' model.	All staff concerned have been involved in the design of the 'To Be' model so understand how it works. Procedures are being written and will be completed by end June.
Managers do not understand general responsibilities and specific responsibilities when authorising claims	Manager briefing note produced and a briefing organised. Timesheet/overtime claims have been updated to give more clarity as to what is expected.	Briefing note circulated and briefing organised.
Independent checks on data input are not comprehensive.	Staff have been informed of what is expected from the checking process. This is being built in to revised procedures.	Action completed.
There is no way to define Terms and Conditions when creating a new employee on Agresso	Add in a flag to define employee's specific T&Cs, e.g. enhanced rate paid on Sundays and run exception reports to highlight where any employees receive payments where they are not eligible to receive them.	Currently in testing, to be in place by the end of June.
The basis for HR/Payroll checks is a manually produced spreadsheet	Checks to be based on a system generated report.	Starters and Leavers reports already in place, however Contract change report will require assistance from Unit 4. In the meantime the 'amendment logging' report provides an audit trail and is being used.
Payroll Team Manager/HR Advisor access too broad.	Permissions to be restricted	Action completed

No system controls in place to stop Payment and Deductions being paid/deducted against certain Pay scales, e.g. overtime.	Use the 'Overtime' tick box in Agresso to stop overtime being paid to employees who are not eligible to receive it (over SCP 28). The secondary check in input will confirm that this has been done. For other payments or deductions, exception reports to be produced to catch any employees who receive payments where they are not eligible to receive them. Such reports to be investigated by the Payroll Officer independent of the processing team.	' Overtime' box in Agresso implemented. An exercise has been completed to 'tick' the box for all staff over SCP28. Exception reports currently being written and tested, to be in place by the end of June.
BACS file not encrypted and Payroll Team manager has access both to run and pay BACS file.	Duties to be segregated so that Payroll Admin run the BACS file and Payroll Team Manager submits the payment. BACS folder to be made read-only so that it cannot be amended.	Action completed Currently in investigation
No controls or report in place to highlight employees with pay anomalies, e.g. no NI/on zero pay/negative pay	Run variants report as a comparison against previous month and investigate anomalies.	Action completed

Whilst improvements are still being made, the cumulative impact of action taken will be sufficient to prevent a reoccurrence.

The internal auditors have been asked to undertake further work to assess changes made. The findings of this work will be reported to the Audit and Risk Committee in due course.

5. RISK MANAGEMENT

RISK	IMPACT	COMMENTS
Time	High	It is imperative that weaknesses in the Council's internal control systems are addressed promptly.
Viability	Low	There are no direct implications within this report.
Finance	Low	There may be a cost to upgrading Agresso (but this is being investigated) and the review of Internal Audit effectiveness will cost in the region of £10,000 (to be funded by the Welland Partners).
Profile	High	Failure to rectify problems would lead to further adverse publicity.
Equality and Diversity	Low	Initial Equality Impact Assessment completed, there are no particular issues in this area.

Background Papers

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A Large Print or Braille Version of this Report is available upon request – Contact 01572 722577.