



# Internal Audit Report 2018/19

## **Debt Management**

July 2019

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## Distribution List

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For information	Andrew Small – Interim Head of Paid Service & Section 151 Officer Audit Committee

This report has been prepared only for Aylesbury Vale District Council in accordance with the agreed terms of reference. The findings should not be relied upon by any other organisation.

# 1. Executive summary

Report classification*	Total number of findings				
	Critical	High	Medium	Low	
	Control design	-	-	-	2
<b>Low Risk (6 points)</b>	Operating effectiveness	-	-	1	1
	<b>Total</b>	-	-	<b>1</b>	<b>3</b>

\*We only report by exception, which means that we only raise a finding / recommendation when we identify a potential weakness in the design or operating effectiveness of control that could put the objectives of the service at risk. The definition of finding ratings is set out in Appendix 1.

## Summary of findings

This report is classified as Low risk and we identified 1 medium risk and 3 low risks. The purpose of the review was to assess the control design and operating effectiveness with regards to the Council's debt management processes.

Following the implementation of the Tech1 finance system and then staff changes resulting from the Commercial AVDC restructure, significant work has been undertaken to improve the management and recovery of debt. This includes creating additional posts in the Corporate Finance team, with specific responsibility for credit control. The functionality of Tech1 has also been considerably improved to enable better review of aged debts and management reporting. The low risk audit report reflects the improvements that have been made to processes and controls in this area.

Further improvements can be made to address the remaining level of risk in the debt management area due to weaknesses in the design of some key controls, particularly around the ability for credit notes to be raised and approved by the same individual, exposing the Council to wrongful credit notes being issued.

Issues have been identified around the timely actioning of debt write off where it has been determined that a debt is irrecoverable. We note that procedures for performing and documenting customer due diligence checks, in higher risk "commercial" income streams should be considered and implemented. There is also inadequate documentation for the quarterly review of customer account changes.

The scope of this audit also covered review of processes to ensure the accurate and complete billing for Council services. Issues have been identified in this area as result of the lack of integration, automated interface and reconciliation between service systems and the general ledger. The issues have been reported as one high, and one medium risk finding in the 2018/19 *General Ledger Reconciliations and Management Information* internal audit report. The overall "low" risk rating of this report relates to debt management and recovery procedures only.

## Summary of Findings

- Credit notes have been raised and approved by the same member of staff with a lack of segregation of duties, increasing the risk of inappropriate credit notes being issued (Finding 1 – Medium)
- Actioning of debt write-offs, where necessary, is not consistently carried out on a timely basis

(Finding 2 – Low)

- There is insufficient evidence of due diligence procedures carried out for new customers for whom the Council provide credit, with insufficient procedures in place to review the appropriateness of existing credit terms provided to current customers (Finding 3 – Low)
- There is no documentation to evidence the review of customer account changes has been completed and action taken where necessary (Finding 4 – Low)

#### **Good Practice Noted**

- There is a sufficiently detailed Corporate Debt Management Procedure (approved May 2019) detailing the procedures staff should follow when billing customers and recovering overdue debts.
- Reporting and review of debt recovery is discussed sufficiently during meetings of the Finance Review Board with KPIs also monitored via the monthly checks and balances spreadsheet.
- Council finance systems restrict amendments being made to transactions limiting the likelihood of fraudulent amendments being made.
- Changes to customer account details are subject to a monthly review to confirm changes are appropriate.
- Finance and services areas have effective communication with one another via meetings and discussions that take place
- Write-offs tested were approved and cleared in line with procedure notes.
- Credit notes tested were matched with invoices.
- There is a documented methodology for calculating an appropriate provision for outstanding debts with evidence in place showing how the final figure was calculated.
- 14 and 28 days debt reminder letters are raised and issued to debtors on a systematic basis in line with the Council's Corporate Debt Management Procedure.

## 2. *Background and Scope*

### *Background*

The Council inputs, records and manages its Billing and Accounts Receivable processes through the main financial system, Tech1. Invoices may be raised by the finance team, or in the service areas, but debt recovery is performed centrally by the transactional finance team.

The income managed on Tech 1 is made up of both statutory income streams (Housing Benefit overpayments), and non-statutory streams such as Commercial Waste, Building Control, Garden Waste, Licencing and Commercial Property. Recently the responsibility for recovery of Housing Benefit overpayment has moved to the Ratings and Recovery team in Customer Fulfilment. The Finance team are therefore responsible for recovery of non-statutory debts.

Invoices are sent to customers electronically and different recovery cycles can be set up for different customer types. Management information from the system both on an overall position and by department is generated. Aged debt analysis is produced from Tech1 and monitored, at a high level, by the Finance Review Board. Write-offs are approved centrally.

The activities within accounts receivable are underpinned by the Council's financial instructions and following previous internal audit recommendations, new debt management procedures have been introduced.

### *Scope*


The scope covered the key risks set out in the Terms of Reference (see Appendix 2). Our testing included:

- Review of the debt recovery policies and procedures
- Reviewing a sample of 15 credit notes issued to confirm suitable approval was provided for each
- Verifying the processes in place to ensure complete and accurate billing of services provided
- Reviewed the functionality of the Tech1 system and how amendments are made to transactions
- Confirming processes in place for new customer due diligence and how changes are made to existing customer account details
- Investigating 20 aged debts from the aged debtors listing to confirm suitable actions have been taken to recover the monies owed
- Reviewing a sample of 10 debt write offs to confirm suitable approval was in place for this
- Review of debt recovery reporting and KPIs used to monitor performance

This does not represent a comprehensive list of tests conducted.

### 3. Detailed findings and action plan

#### 1. Ability for credit notes to be raised and approved by the same individual – Operating effectiveness

Finding		
<p>To ensure that only accurate and appropriate credit notes are raised and issued to customers, the Council has an approval process in place where credit notes are matched to invoices prior to a member of the finance team approving the credit note to be posted. The credit notes should be raised and approved by different individuals.</p> <p>We tested a sample of 15 credit notes, totalling over £300,000, over the period April 2018 to March 2019 to confirm this process had been followed and found that in two cases the credit note was created and approved by the same person. The combined value of these credit notes was £43k. Although there was legitimate rationale behind why these credit notes were raised, credit notes should not be raised and approved by the same individual to maintain appropriate segregation of duties.</p> <p>Current system workflows within Tech1 do not prevent this from being possible.</p>		
Risks / Implications		
<p>Credit notes being raised and approved by the same individual increases the risk of inappropriate credit notes being raised.</p>		
Finding rating	Action Plan	
<p><b>Medium</b></p> 	<p>a) Communicate this finding by email and verbally to all staff involved with credit notes to reinstate the expected practices to help ensure all credit notes are being created and approved by separate individuals to maintain segregation of duties.</p>	<p><i>Responsible person / title</i></p> <p>Amanda Williams - Transactional Finance Team Lead</p>
	<p>b) Investigate the capability of the Tech1 system to determine if workflows can be implemented which prevent credit notes being raised and approved by the same individual.</p>	<p><i>Target date</i></p> <p>a) 31 July 2019 b) 30 September 2019</p>

## **2. Debts are not written off on a timely basis – Control effectiveness**

### *Finding*

To ensure timely recovery of moneys owed, aged debts should be regularly reviewed with processes in place to chase and recover payment in line with the Corporate Debt Management Procedures. This includes sending reminder letters 14 and 28 days after the agreed payment terms have elapsed. If the debt still remains unpaid after these actions then the Credit Control Officer systematically chases these debts, applying appropriate recovery mechanisms for different non statutory income streams, determined by the unique nature of the debt.

A review of the aged debtor's listing at 31 March 2019 identified that the majority of overdue debt falls within the 'older than 120 days' category (£1,041,893 – 44.7%) compared to debt between 30-120 days (£162,575 – 4.4%) with the remainder being current debt (£1,640,391 – 44.7%). This suggests the Corporate Debt Management Procedures are being effectively implemented to recover debt in a timely manner, with the main concerns being with the recovery of long standing debt, much of which arose before the current team and procedures were in place. Action is now being taken by the Council to progress these debts, either through recovery or write-off.


We tested a sample of 20 debts greater than 120 days. Exceptions were identified where the corporate debt management procedure with respect to write-offs, had not been followed:

- In six instances the debt had been recorded as unrecoverable or an error and set to write-off, however this had not been actioned at the time of testing, with the oldest debt remaining in this status since January 2017.
- For one debt with an outstanding balance of £2,948, there was no evidence of any recovery action since the debt was incurred in April 2014. This was because the debt was an item which was transferred to Tech 1 from the previous Aptos accounting system and no details exist in Tech1. It has since been processed for write-off.
- One of the debts selected in our sample related to the Council's former contract for collection of recycling waste. There was an arrangement in place for "self-invoicing" whereby AVDC received income based on the expected tonnage, with a process for credit notes to adjust for variation in actual tonnage collect. The contract with the supplier came to end in August 2018 and there were a number of outstanding credits and invoices on the account. Subsequently a full reconciliation has been performed, with progress reported to the Finance Review Board. The final position has been agreed with the supplier, with a remaining balance on AVDC's ledger of £21,490. This amount needs to be written off, but was not set to write off until after completion of our audit testing, in July 2019. This will require Cabinet Member approval due to the high value.

For the remaining items within the sample, sufficient recent evidence was provided that suitable recovery action was being taken.

### *Risks / Implications*

Where debts are not written-off in a timely manner, in line with the Corporate Debt Management Procedures, the Council's debtors balance could be misstated.

Finding rating	Action Plan	
<p><b>Low</b></p> 	<p>A monthly review of the aged debtors listing should be undertaken to identify all longstanding debts for which no action is being taken.</p>	<p><i>Responsible person / title</i></p> <p>Amanda Williams - Transactional Finance Team Lead</p>
	<p>Where items are identified as being irrecoverable, the action being taken should be confirmed with service areas, and they should be processed for write-off that month, with approval in line with the Debt Management Procedure. This should be followed up on in the following month to confirm this has been actioned.</p>	<p><i>Target date</i></p> <p>30 September 2019</p>



### 3. Lack of customer due diligence procedures – Control design

#### Finding

Credit terms differ depending on the customer, with the most common terms being for payment within 30 days of the transaction.

For non-statutory areas which have higher value transactions, we would expect there to be sufficient and appropriate due diligence procedures carried out, such as credit checks or basic background searches, with the extent of these procedures being proportional to the extent of credit extended. This will allow the Council to confirm the nature and background of the customer, and their ability to make payments in line with the credit terms offered.

The largest area of non-statutory debt is Commercial Property. This is actively monitored and settlement arrangements are in place for significant outstanding balances. Discussions with Council staff identified that, whilst basic due diligence procedures such as review of company accounts or D&B searches are completed for new customers within the Commercial Property service, no procedural guidance or documentation of these checks was available to evidence that this was routinely carried out. Additionally, no checks are undertaken for ongoing contracts to confirm whether the existing credit terms are suitable and assess the customer's continued ability to make payments.

#### Risks / Implications

A lack of due diligence procedures increases the risk of the Council engaging with customers who are not appropriate and increasing the risk of taking on irrecoverable debts.

#### Finding rating Action Plan

**Low**



- a) An assessment of those higher risk areas for debt recovery should be undertaken, focusing on those with high value, low volume transactions such as Commercial Property, to identify the extent of due diligence procedures which would be appropriate. This could include setting thresholds above which these procedures are required.
- b) Once determined, these procedures should be implemented to confirm the background and nature of the customer as well as determining their ability to meet repayment terms, with completion of these procedures being documented to evidence completion. Due diligence procedures should be repeated at pre-determined intervals based on the risk and value of the customer contract, identifying any actions necessary to prevent any future irrecoverable debts, such as renegotiating payment terms (from quarterly to monthly for example).
- c) The capability of Tech1 should be investigated to enable this to support any credit limits which are imposed on certain customers.


#### Responsible person / title

Amanda Williams - Transactional Finance Team Lead

#### Target date

- a) 31 July 2019
- b) 30 September 2019
- c) This action is recognised as a control improvement but is not practical to implement. The Tech1 system will not be used by the new Unitary Council.

#### 4. Insufficient documentation of review to confirm appropriateness of customer account changes – Control design

Finding		
<p>Changes to customer account details are made by members of the finance team according to requests made by customers or Hornbill requests from service areas. There is a full audit trail maintained on Tech1 of all changes made to customer accounts and who actioned those changes. On a quarterly basis a report is pulled from Tech1 with a full record of all customer account changes made in the prior quarter. This report is sent to the Corporate Finance Manager for review.</p> <p>Discussions with the Corporate Finance Manager determined that on receipt of this report, a sample of changes are selected and conversations are carried out with members of the finance team to confirm the changes were made appropriately and for legitimate reasons.</p> <p>However, we found that there is no record produced relating to this review to detail the changes sampled, allowing confirmation that an appropriate number of changes are reviewed, or the outcome of the review and whether any further actions or investigations are required.</p>		
Risks / Implications		
Fraudulent changes could be made to customer account details resulting in financial loss to the Council.		
Finding rating	Action Plan	
<p><b>Low</b></p> 	When completing the review of customer detail changes, record on the change report which items have been reviewed, the outcome of the review and where necessary, what actions were taken to remedy any issues identified.	<p><i>Responsible person / title</i></p> <p>Amanda Williams – Transactional Finance Team Lead</p> <hr/> <p><i>Target date</i></p> <p>30 September 2019</p>

## Appendix 1. Finding ratings and basis of classification

### Report classifications

The overall report classification is determined by allocating points to each of the individual findings included in the report.

Findings rating	Points	Overall report classification	Points
Critical	40 points per finding	● Critical risk	40 points and over
High	10 points per finding	● High risk	16– 39 points
Medium	3 points per finding	● Medium risk	7– 15 points
Low	1 point per finding	● Low risk	6 points or less

### Individual finding ratings

Finding rating	Assessment rationale
Critical	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>● <b>Critical</b> impact on operational performance; or</li> <li>● <b>Critical</b> monetary or financial statement impact <b>[quantify if possible = materiality]</b>; or</li> <li>● <b>Critical</b> breach in laws and regulations that could result in material fines or consequences; or</li> <li>● <b>Critical</b> impact on the reputation or brand of the organisation which could threaten its future viability.</li> </ul>
High	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>● <b>Significant</b> impact on operational performance; or</li> <li>● <b>Significant</b> monetary or financial statement impact <b>[quantify if possible]</b>; or</li> <li>● <b>Significant</b> breach in laws and regulations resulting in significant fines and consequences; or</li> <li>● <b>Significant</b> impact on the reputation or brand of the organisation.</li> </ul>
Medium	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>● <b>Moderate</b> impact on operational performance; or</li> <li>● <b>Moderate</b> monetary or financial statement impact <b>[quantify if possible]</b>; or</li> <li>● <b>Moderate</b> breach in laws and regulations resulting in fines and consequences; or</li> <li>● <b>Moderate</b> impact on the reputation or brand of the organisation.</li> </ul>
Low	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>● <b>Minor</b> impact on the organisation’s operational performance; or</li> <li>● <b>Minor</b> monetary or financial statement impact <b>[quantify if possible]</b>; or</li> <li>● <b>Minor</b> breach in laws and regulations with limited consequences; or</li> <li>● <b>Minor</b> impact on the reputation of the organisation.</li> </ul>
Advisory	<p>A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.</p>

## Appendix 2. Terms of reference

The key risks agreed in the Terms of Reference are set out below. Each finding in the report is linked to a key risk from the Terms of Reference.

Sub-process	Risks	Objectives
Policies and procedures	Inadequate policies and procedures to instruct staff to accurately invoice, collect, record and recover income	<ul style="list-style-type: none"> <li>• Policies and procedures are clear, understood and followed to ensure the objectives of activity are met</li> </ul>
Invoicing, recording and collecting income	<p>Inaccurate records and invoices, resulting in non-receipt of payments</p> <p>Unauthorised credit</p>	<ul style="list-style-type: none"> <li>• Invoices are raised for accurate amounts in a timely manner and issued to the correct customers</li> <li>• Invoices are raised for all income due to the Council, per records held on individual sub-systems</li> <li>• There is an adequate approval and review process in place to confirm the accuracy of billing</li> <li>• Credit notes are matched to invoices and are appropriately approved.</li> <li>• Cash collected in matched to invoice, discrepancies are investigated and resolved</li> </ul>
New customers and changes to standing data or transactions	<p>Fraudulent amendments to income due</p> <p>Inappropriate customers given credit</p>	<ul style="list-style-type: none"> <li>• New customers are subject to sufficient due diligence to provide reasonable comfort over the nature and background of the customers</li> <li>• New or existing customer change controls are in place to safeguard the integrity of changes made to data held</li> <li>• Amendments to transactions are subject to sufficient approval procedures to validate their accuracy</li> </ul>
Recovery and write-off	<p>Cost of recovery</p> <p>Income due not collected</p>	<ul style="list-style-type: none"> <li>• Debt recovery arrangements are in place to maximise the income received into the Council</li> <li>• Robust arrangements are in place to review and approve debt write-offs in line with the Corporate Debt Policy.</li> <li>• Effective communication between service areas and the Finance team facilitates the debt collection process</li> </ul>
Reporting and oversight of debt	Under recovery of income, increased debt write offs	<ul style="list-style-type: none"> <li>• Reporting is adequate to enable effective monitoring and oversight of debt. Issues are appropriately escalated.</li> <li>• Performance indicators are monitored</li> </ul>