

Finance and Resources Committee – 21 June 2011

Internal Audit Report – Financial Systems

Executive summary and recommendations

Introduction

PKF has undertaken a review of financial systems, in accordance with the internal audit plan agreed by the audit committee in February 2010. The report is attached as an appendix to this paper.

The report rated this area as satisfactory and made three recommendations.

Decision

The Committee is asked to note the paper, no decision is required.

Background information

The Audit Committee discussed the report in the March 2011 meeting.

Financial implications

None

Appendices

Appendix One – Financial systems review.

Date of paper

6 June 2011



Health Professions Council

Financial systems review 2010/11

Final December 2010

Confidential



Accountants &
business advisers

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1 Introduction and scope

1.1 In accordance with the 2010/11 internal programme for the Health Professions Council (“HPC”) that was agreed with the Audit Committee in February 2010, we have undertaken a review of the controls in operation over the organisation’s financial systems.

1.2 The key financial risks identified by the HPC for 2010/11 were as follows:

Financial management	Financial processing
Mismatch between Council goals & approved financial budgets	Registrant credit card record fraud/ theft
Insufficient cash to meet commitments	Receipt of fee income as per collection schedule
Major project cost over-runs	Unauthorised payments to organisations
Unexpected rise in operating expenses	Unauthorised payments to personnel
Loss in value of investment portfolio	Mis-signing of cheques (forgery)
Inability to pay creditors	Unauthorised removal of assets
Inability to collect from debtors	Payroll process delay or failure
Money Market provider insolvency or fraud	
Financial distress of suppliers causes loss of service	

1.3 Our review therefore focused on the internal control arrangements for managing the above risks.

1.4 The following financial risks identified by the HPC are managed through the external audit and other processes. In order to avoid duplication of audit effort, we have not included these as part of this review.

- PAYE/NI compliance;
- Corporate tax compliance;

- Non compliance with FReM reporting;
 - Qualified opinion received by the Auditors on the Statutory Financial Statements; and
 - Late submission of the Annual Report, beyond sector standards.
- 1.5 The risk of fraudulent applications by registrants has previously been addressed by our review of the Registration Department, the findings of which were reported in March 2008. There has been no indication that controls have weakened in that area since the time of our last review and we have therefore focused our audit activity towards other areas where there is a greater need for assurance.
- 1.6 We also followed up the recommendation that we raised as part of our 2009/10 review to confirm that this had been implemented by management.
- 1.7 The work was carried out primarily by holding discussions with relevant staff and management, reviewing any available documentation and undertaking detailed testing on a sample basis, where required. The audit fieldwork was completed in November 2010.
- 1.8 This report has been prepared as part of the internal audit of the Health Professions Council under the terms of our engagement letter for internal audit services. It has been prepared for the Health Professions Council and we neither accept nor assume any responsibility or duty of care to any third party in relation to it.
- 1.9 The conclusions and recommendations are based on the results of audit work carried out and are reported in good faith. However, our methodology is dependent upon explanations by managers and sample testing and management should satisfy itself of the validity of any recommendations before acting upon them.

2 Executive summary

- 2.1 This report summarises the work undertaken by PKF within the agreed scope of our review of the financial systems in operation at the HPC.

Background

- 2.2 The HPC's budget for 2010/11 anticipated that the organisation would receive around £16.8 million this year from applicants and registrants' fees (£15.6 million - 2009/10). This is the organisation's primary source of income. The HPC's original budget aimed to generate a small surplus of around £20,000 for the year.
- 2.3 All financial processing is undertaken in-house by the Finance Department. The team has remained largely as it was at the last time we reviewed this area. The financial system was upgraded to Sage 200 from 1st April 2008. Payroll is processed on a separate standalone Sage payroll system and registrants' income is recorded on the Netregulate system.

Our assessment

- 2.4 Based on our review work, we have concluded that the HPC's financial systems were **satisfactory** and were operating effectively at the time of our audit visit. However, we noted three areas where there remains scope for improvement to enhance the control framework and to meet best practice going forward.
- 2.5 The principal findings of our work are set out in the paragraphs below.

Principal findings

- 2.6 Our testing indicated that the HPC's budget setting and financial reporting arrangements were operating effectively. Detailed steps are taken to refine the annual budget each year and to evaluate the underlying assumptions behind the HPC's forecasts within the context of the organisation's Five Year Plan.
- 2.7 We noted that an updated Five Year Plan has not been produced during November 2010 as usual. We understand that the principal reason for this is that forecasting is difficult to undertake at this stage in the light of the uncertain consequences (which could have a financial impact) of the transfer of the regulatory functions of the General Social Care Council ("GSCC") to the HPC and the White Paper due to be published in February 2011. However, we understand that management have reviewed the previous Five Year Plan and are satisfied that it remains a sufficiently useful tool to inform budget planning for 2011/12. Estimates relating to the impact of the GSCC transfer will be included in next year's budget and financial planning going forward, where appropriate.

- 2.8 Detailed management accounts and a commentary on the key variances were prepared every month and a revised forecast had been produced as at 30th September and considered by the Finance & Resources Committee in November 2010.
- 2.9 At the time of our audit, the HPC was forecasting that it would achieve a surplus of just under £507,000 compared with the original budgeted surplus of around £20,000. We understand that this is mainly due to cost reductions. The principal reasons for reduced costs noted in the Finance Department Report included planned and managed delays in recruiting to some positions, especially in the Fitness to Practise, Policy, Operations, Registrations, Finance and Communications departments and savings on panel costs. A further forecast is scheduled to be prepared at the nine month period to 31st December, which will be reported to the March 2011 meeting of the Finance & Resources Committee.
- 2.10 The HPC's reserves policy is to retain an amount equivalent to a minimum of three average months of operating expenditure (around £3.9 million) in the form of liquid investments and working capital (before deducting deferred income).
- 2.11 We noted that the reserves policy was reviewed in detail at the 16th March 2009 meeting of the Finance & Resources Committee, when it was agreed to continue with the policy as it stood for a further two years following a consideration of the likely impact on reserves of the current Five Year Plan.
- 2.12 The level of these reserves is monitored closely and reported in the Finance Department Report presented to the Finance & Resources Committee. As at 30th September 2010 we noted that the sum of working capital and investments amounted to around £7.2 million before deducting deferred income. In our view, this approach should enable the HPC to manage any immediate financial pressures (such as tribunal exceptional costs) in the short term.
- 2.13 The HPC's Council and the Finance & Resources Committee were also provided with the reports necessary to enable them to undertake their functions. Additional papers are regularly prepared on key emerging issues.
- 2.14 In accordance with best practice, the HPC has taken steps to review its investment approach and to monitor the performance of its fund managers. A detailed paper setting out various options for consideration was presented to the November 2010 meeting of the Finance & Resources Committee. We understand that a recommendation from the Finance & Resources Committee that the HPC should no longer investment in equities and bonds and hold the balance of investment funds as cash will be presented to Council in February 2011.
- 2.15 Our testing indicated that tight control is maintained over cash, credit card receipts and expense claims. We also noted that payroll processing controls were operating effectively to ensure that the payroll was complete accurate and processed on a timely basis.

- 2.16 Procedures were operating as expected over purchase ledger processing. However, the continuing use of the manual procedures alongside the automated purchase ordering processes indicates that the anticipated benefits of the PRS system are not at present being delivered in full. We raised a recommendation in relation to this matter in our previous report in November 2009.
- 2.17 We understand that some key decisions regarding the HPC's financial systems have been taken during 2010/11, which have meant that the complete automation of purchase ordering using the PRS system has not been possible. Following a review of options undertaken by the Finance Department it has been decided to align the necessary upgrade to the PRS system with a planned upgrade to the Sage financial system and the Fitness to Practise IT system. We understand that the aim of this is to ensure that the correct versions are installed to maximise the compatibility between the systems. This is scheduled to take place by September 2011.
- 2.18 Whilst we concur with this approach, we believe that it remains important that the HPC ultimately adopts a uniform process for purchase ordering and all purchase orders are ultimately to be raised on the PRS system. We have therefore re-raised our recommendation from 2009/10.
- 2.19 The figures recorded in the main accounting system should be reconciled to Netregulate each month with differences investigated as they arise. During 2010/11, our testing indicated that the Netregulate reconciliation had not been undertaken each month. The first reconciliation for 2010/11 was undertaken in June 2010 and the subsequent reconciliations to September 2010 had been performed at the time of our audit visit.
- 2.20 We understand that differences arise (which typically amount to around £50,000 each month) that relate to timing differences between receipts being recorded on Netregulate and clearing the bank account. However, we are advised that the current difference of £58,399 relates to transactions more than six months old. We have therefore raised a recommendation in relation to this matter.
- 2.21 Our sample testing indicated that the other key month end reconciliations and checks were all being performed on a timely basis.
- 2.22 However, in order to demonstrate clearly when the review of the reconciliation has taken place, thereby evidencing that the control is in operation throughout the financial year, we believe that the reviewer should date as well as sign off the bank reconciliation in accordance with best practice. We have therefore raised a further recommendation in relation to this matter.
- 2.23 A trial balance is produced routinely at month end and the HPC's income and expenditure and balance sheet items are clearly set out in the organisation's coding structure.

- 2.24 From our review of the trial balance, we noted that there was an imbalance of 6 pence. We noted a same type of difference of £1 in 2008, which was investigated by management at that time and no significant system problems or processing errors were identified as a result. We understand however that the difference has now been corrected and we have not therefore raised a recommendation.
- 2.25 A suspense account is maintained as code 9999. This code is used to process any transactions that have been identified as requiring amendment or further investigation before the correct entry can be recorded.
- 2.26 We noted that all of these items had been corrected by management on a timely basis and the balance on the suspense account as at 30th September was £Nil.

PKF (UK) LLP
December 2010

3 Detailed findings

Background

- 3.1 The HPC's budget for 2010/11 anticipated that the organisation would receive around £16.8 million this year from applicants and registrants' fees (£15.6 million - 2009/10). This is the organisation's primary source of income. The HPC's original budget aimed to generate a small surplus of around £20,000 for the year.
- 3.2 The main components of the organisation's budgeted expenditure for 2010/11 related to the following departments:
- Communications (£1.1 million);
 - Fitness to practice (£7.1 million);
 - Registrations (£1.6 million);
 - IT department (£1 million); and
 - Facilities management (£0.8 million).
- 3.3 Payroll costs including temporary staff were budgeted to be around £5.7 million.
- 3.4 The HPC had net assets amounting to just over £0.9 million as at 31st March 2010. Fixed assets amounted to around £3.5 million, over £2.3 million of which relates to the organisation's premises in Kennington. A capital budget of around £1.2 million was set for 2010/11, which is primarily to be used to undertake various ICT projects, notably the FTP case management system implementation. Financial investments, including deposits and equities were valued at just over £1.9 million as at 31st March 2010. The HPC had cash holdings of just over £5.6 million as at 31st March 2010.

Financial management

Budget setting

- 3.5 Key unknowns for the HPC annual planning process and the drawing up of the Five Year Plan are the number of new professions and the timing of register transfer. The Registrant Forecasting Model is therefore a key planning tool that is updated annually to reflect the HPC's expectations of likely registrant numbers and timing of register transfers for the following year.
- 3.6 The Five Year Plan quantifies HPC's Strategic Intent in financial terms. It informs longer term planning, including fee setting. It is an Excel spreadsheet model containing two years actual results, five years forecasts and the current year budget.

- 3.7 The model also includes the main non-financial trends (e.g. registrant forecasts) together with inflation estimates and any changes to the HPC's operating environment.
- 3.8 The Five Year Plan is normally updated between August and October following detailed discussions with budget holders to reflect updates to the assumptions previously made.
- 3.9 A draft version of the revised plan is then considered by the Executive Management Team ("EMT") and reviewed against the HPC's strategy and objectives going forward.
- 3.10 Once EMT has approved the Five Year Plan, a final version is sent to the Chief Executive and Registrar, Finance and Resources Committee & Council for approval. We noted that the most recent version of the Five Year Plan was approved by the Finance & Resources Committee in November 2009.
- 3.11 The preparation of the annual budget is co-ordinated by the Finance Department in accordance with a timetable designed to enable the Council to approve the final budget at its March meeting.
- 3.12 The Financial Controller prepares the income budget. This is based upon the updated Registrant Forecasting Model and any other known sources of income.
- 3.13 The Financial Controller prepares a budget preparation pack for budget holders including prior year actual results, latest estimated spend for the current year, budget lines and instructions.
- 3.14 Budget holders are required to complete a standard template setting out their expected expenditure budgets for the coming year. These are then discussed with them in detail by the Chief Executive and Registrar, the Director of Finance and the Financial Controller.
- 3.15 The draft budget submissions are then updated to reflect these discussions and further review meetings are held where necessary to arrive at a final submission.
- 3.16 The expenditure budget preparations include consideration of prior year actual expenditure together with known shifts in projects and programmes scheduled for the financial year.
- 3.17 Once all the budget submissions have been received, the Financial Controller collates the data to produce an overall draft HPC budget for discussion with the Director of Finance and the Chief Executive and Registrar.
- 3.18 EMT holds a one-day session off-site in January to review the draft budget. This session is also attended by the Chair of the HPC and the Chair of the Finance & Resources Committee, together with other relevant managers including the Office Services Manager and Head of Registration.

- 3.19 The draft budget is then presented to a first meeting of the Finance & Resources Committee in February for consideration. The budget is then reviewed once again by the Executive before being presented to a second meeting of the Finance & Resources Committee in March before being recommended to Council for approval.
- 3.20 Our review indicated that the annual budget for 2010/11 was prepared in accordance with the HPC's strategic objectives and presented to a meeting of the Finance & Resources Committee on 10th February 2010 for consideration. It was then reviewed once again by a second meeting of the Finance & Resources Committee on 17th March 2010 and recommended for approval by Council at its meeting on 25th March 2010. Budget holders are then required to sign up formally to confirm their ownership of the budget that has been agreed.
- 3.21 In our view the arrangements set out above enable the HPC to effectively manage the risk that there may be a mismatch between Council goals and approved financial budgets.
- 3.22 We noted that an updated Five Year Plan has not been produced during November 2010 as usual. We understand that the principal reason for this is that forecasting is difficult to undertake at this stage in the light of the uncertain consequences (which could have a financial impact) of the transfer of the regulatory functions of the General Social Care Council ("GSCC") to the HPC and the White Paper due to be published in February 2011. However, we understand that management have reviewed the previous Five Year Plan and are satisfied that it remains a sufficiently useful tool for informing budget planning purposes for 2011/12. Estimates relating to the impact of the GSCC transfer will be included in next year's budget and financial planning going forward, where appropriate.

Budgetary control and financial reporting

- 3.23 We noted that management accounts are produced on a monthly basis. The Finance Department aims to issue these within fifteen working days of each month end. These include detailed management accounts for income and operating expenditure, income by profession, expenditure report by department, balance sheet, capital expenditure analysis against budget and a cash flow forecast.
- 3.24 In our view the detailed information provided in the management accounts enables EMT and the Finance Department to monitor and to take the necessary action to address cash flow shortfalls (the cash flow forecast), unexpected rises in operating expenses - especially tribunal exceptional costs- (income and expenditure account) and any potential loss in value of the HPC's investment portfolio (balance sheet).
- 3.25 The balance sheet also highlights the HPC's working capital position enabling management to assess the organisation's success in collecting debts when they fall due and its capacity to pay creditors on time.

- 3.26 The HPC's reserves policy is to retain an amount equivalent to a minimum of three average months of operating expenditure (around £3.9 million) in the form of liquid investments and working capital (before deducting deferred income). We noted that the reserves policy was reviewed in detail at the 16th March 2009 meeting of the Finance & Resources Committee, when it was agreed to continue with the policy as it stood for a further two years following a consideration of the likely impact on reserves of the current Five Year Plan.
- 3.27 The level of these reserves is monitored closely and reported in the Finance Department Report presented to the Finance & Resources Committee. As at 30th September 2010 we noted that the sum of working capital and investments amounted to around £7.2 million before deducting deferred income.
- 3.28 In our view, this approach should enable the HPC to manage any immediate financial pressures (such as tribunal exceptional costs) in the short term.
- 3.29 The management accounts are reviewed in detail by EMT each month. The Financial Controller prepares a narrative summary (Notes to the Income and expenditure account) explaining the key variances and drivers of the HPC's financial position.
- 3.30 A revised financial forecast was prepared as at 30th September 2010 and considered by the November meeting of the Finance & Resources Committee. This indicated that the HPC is now forecasting that it will achieve a surplus of just under £507,000 compared with the original budgeted surplus of around £20,000.
- 3.31 We understand that this is mainly due to cost reductions. The principal reasons for reduced costs noted in the Finance Department Report included planned and managed delays in recruiting to some positions, especially in the Fitness to Practise, Policy, Operations, Registrations, Finance and Communications departments and savings on panel costs.
- 3.32 A further forecast is scheduled to be prepared at the nine month period to 31st December, which will be reported to the March 2011 meeting of the Finance & Resources Committee.
- 3.33 The Finance & Resources Committee routinely receives a Finance Department Report. The Council also receives a copy of the summarised financials which is presented as part of the Chief Executive's Report to Council. For example, the July financial position was reported to the Council meeting on 17th September 2010.

Financial processing

Income systems

- 3.34 Income from registration fees is charged in accordance with the Fees Order approved by Parliament. The following fees are currently chargeable across all professions:
- Initial registration fee of £53;

- Readmission fee (registrant comes back on to the register) of £115;
 - Yearly registration renewal of £76;
 - One-off international scrutiny fee of £420; and
 - One-off grandparenting scrutiny fee of £420.
- 3.35 Payment methods include direct debit, credit cards and cheques. It is the HPC's policy not to accept cash payments. Our sample testing did not identify any such payments. Scrutiny fees cannot be paid for by direct debit. Just over 80% of registration income is received by direct debit thereby significantly reducing the HPC's exposure to debt collection risks or postal strikes. As part of the registration process, potential registrants are encouraged to provide the Registration Department with direct debit instructions.
- 3.36 These details are then scanned and input into the Netregulate system and the physical mandate is sent off to the bank of the registrant. A period of fifteen working days is permitted between sending the mandate to the bank and collecting the fee so that the bank can activate the direct debit instruction.
- 3.37 The Finance Department match and post direct debit receipts to the Registrants' accounts on the Netregulate system using payment reports downloaded from BACS. Rejections arise when the HPC receives notice from the registrant's bank (bank statement) that their direct debit mandate arrangement has been rejected.
- 3.38 In these circumstances, the Transactions Manager contacts the registrant by letter within 10 days of receiving bank notification, and three weeks grace is allowed for them to pay the fee owing or to set up a new direct debit.
- 3.39 If no contact is made by the end of the three weeks, the registrant is advised in writing by the Finance Department that they will be lapsed from the register and will have to go through the readmission process to come back onto the register.
- 3.40 Credit card income is received from the Registration Department. At the end of each day the Department prints off a reconciliation report from their Streamline credit card machines and checks it to a reconciliation listing of all the transactions posted to confirm that all credit card payments have been received and recorded - thereby mitigating the risk of credit card fraud.
- 3.41 Cheques for fee income are received through the post. Mail is received in the post room and distributed to the various departments. The Registration Department inputs the money received from the registration applicant onto the Netregulate system and records the income on individual logs titled "General Cheques Received."

- 3.42 On a daily basis the cheques are taken to the Finance Department and kept overnight in a locked safe. There are two keys for the safe (one is kept by the Financial Accountant and other kept by the Office Services Manager).
- 3.43 Each morning the Transactions Officer checks the cheques received to the log and to Netregulate and evidences this check on the log. The paying in slip is completed and monies are banked weekly. Monies are banked daily during busy periods. The Courier company (TNT Express) signs for receipt of the cheques and postal orders and the Finance Department also signs the courier sheet.
- 3.44 Registrants can seek a refund of their registration, by three methods – voluntary removal, becoming lapsed from the register with credit on their account and overpayment. Refunds can only be paid by cheque in accordance with the HPC's cheque payment procedures. Only Finance Department staff members can action refunds on Netregulate and issue cheques.
- 3.45 The figures recorded in the main accounting system should be reconciled to Netregulate each month with differences investigated as they arise.
- 3.46 During 2010/11, our testing indicated that the Netregulate reconciliation had not been undertaken each month. The first reconciliation for 2010/11 was undertaken in June 2010 and the subsequent reconciliations to September 2010 had been performed at the time of our audit visit.
- 3.47 We understand that differences arise (which typically amount to around £50,000 each month) that relate to timing differences between receipts being recorded on Netregulate and clearing the bank account. However, we are advised that the current difference of £58,399 relates to transactions that are more than six months old. We have therefore raised the following recommendation.

Recommendation

R1. Differences arising from the reconciliation between the Netregulate system and the main accounting system should be analysed and details of this should be included in the documentation to support the reconciliation. This should be undertaken during the NAO's interim audit in February 2011 and signed off by the Financial Controller when completed.

Expenditure systems

- 3.48 Payroll costs are the most significant area of expenditure incurred by the HPC, representing around £5.7 million (34%) of total budgeted expenditure for 2010/11. As a result, the number of full time equivalent staff is considered carefully as part of the annual budget setting process.

- 3.49 The Financial Controller obtains details of all proposed new posts from budget holders. These are sent to the Director of Human Resources in the first instance to obtain a salary rating ("IDS"). Posts are then discussed with the Chief Executive and Registrar before being incorporated within the HPC's draft annual budget for consideration and approval by the Finance & Resources Committee and the Council.
- 3.50 Payroll is processed on a Sage stand alone system within the Finance Department. System access is password restricted to two members of the Finance Team.
- 3.51 Permanent payroll changes such as starters, leavers and salary changes are initiated upon receipt of the relevant supporting documentation from the HR Department. For example for all new employees a copy of their employment contract, P45 and payroll detail form are required before the individual can be set up on the HPC's payroll.
- 3.52 Temporary amendments to the payroll such as overtime can only be processed upon receipt of an overtime claim form that has been signed by the relevant line manager.
- 3.53 Before processing the payroll, each departmental manager is emailed the staff cost break down for their department requiring them to confirm the amount to be charged against their budget.
- 3.54 The Human Resources Department is also emailed the total number and names of employees that are about to be paid so that these can be checked for "ghost" employees.
- 3.55 Two pay runs are undertaken each month: one for employees and one for Council and Committee members. An excel spreadsheet (payroll summary form) is used to update the payroll system for any amendments required. The pay run is then prepared and a pre-check folder is also produced including the key payroll reports for the month.
- 3.56 The reports are reviewed and signed by the Director of Human Resources, the Director of Finance and the Chief Executive and Registrar before the payment is authorised. Payments are currently made using the Natwest Autopay facility. The Credit Transfer forms require the signature of two individuals included on the HPC's bank mandate before being faxed to Natwest for processing.
- 3.57 Our sample testing indicated that these controls were operating effectively and should ensure that the risk of unauthorised payments to personnel is mitigated.
- 3.58 We noted that the Autopay report for the employees April 2010 pay run was missing from the file. However, the signed Credit Transfer form had been retained, evidencing that the necessary authorisation checks had been undertaken before the payment was processed.
- 3.59 The remaining £11.1 million of the HPC's annual budgeted expenditure is subject to purchase ledger controls and procedures.

- 3.60 There are four main categories of purchase ledger transaction as follows:
- Council/ committee members' allowances and expenses;
 - Partners' expenses;
 - Employees' expenses; and
 - Purchases from suppliers.
- 3.61 There are three possible tax categories for Council/ Committee members. Category 1 members are treated as office holders and payments to them are therefore processed through the HPC payroll in accordance with the procedures described in the paragraphs above.
- 3.62 Category 2 members claim expenses through their employer. The employer invoices the HPC and the invoice is processed through the purchase ledger. Category 3 members are registered as self- employed. Members are required to declare their tax status upon appointment and complete the declaration forms. These are held on file in the Finance Department.
- 3.63 Category 2 and 3 members are required to complete a claim form, attaching the supporting receipts for all claims above £5 before submitting the claim to the Finance Department for processing. The Purchase Ledger Officer stamps the forms received. The claim is then sent to the relevant budget holder for authorisation.
- 3.64 Partners include visitors, registration, legal and medical assessors, panel members and chairmen. In almost all cases they are deemed to be self-employed and are required to complete a Partners Expense Claim form, attaching the relevant invoice, which is checked and authorised in the same way as for category 2 and 3 members.
- 3.65 Employees are required to complete an expense claim form, attaching the supporting receipts for all claims above £5 and obtaining authorisation from their line manager (or the Chief Executive) before submitting the claim to the Finance Department for processing in accordance with the purchase ledger procedures noted above. Claims made by the Chief Executive require the authorisation of the Chair and the Director of Finance.
- 3.66 Our sample testing indicated that the HPC's procedures for processing were operating effectively and should mitigate the risk of expense claim abuse by members, partners and employees.
- 3.67 Additional controls have been introduced to mitigate the risk of financial distress of suppliers. We were advised that the financial status of the HPC's key suppliers is now periodically monitored using Experian reports.

- 3.68 We understand that around 40% of the HPC's purchasing transactions are still conducted using the On-line Purchase Requisition System ("PRS") that was implemented in February 2009. Access to the PRS system is password protected. Authorised users are required to raise a purchase request, selecting from a drop down list of approved suppliers, cost codes and authorised "approvers".
- 3.69 This generates a purchase request that is automatically transmitted to the approver(s) assigned to the cost code. A purchase order can only be created once the approver has electronically confirmed the request. Different tiers of authorisation have also been built into the system. For example if a purchase request is made for £7,500 the individuals authorised to approve expenditure between £1,001 and £8,000 for that cost code are notified. There is an automated transfer of approved orders from the PRS system to the Sage purchase ledger.
- 3.70 We noted that the HPC's manual ordering procedures also continue to operate as follows, where the PRS system is not used. Each department is required to complete a pre-numbered, three part purchase order which must be approved by a budget holder or their delegate named on the purchase order/ invoice signatory list. The department send the white copy of the order to the suppliers directly and retain the blue and pink copies.
- 3.71 Invoices are sent to the Finance Department by the supplier. Upon receipt of the supplier invoices, the Finance Department stamp these and pass them on to the relevant budget holder for approval and coding after posting the invoice details to the unauthorised invoices purchase ledger control account. The budget holder matches the invoice to the purchase order before approval.
- 3.72 Transactions above £8,000 require the additional authorisation of the Chief Executive. The Chair or the Chair of the Finance & Resources Committee is required to countersign transactions above £25,000.
- 3.73 Once approved, the invoices are received back by the Finance Department, the nominal codes are then checked by the Purchase Ledger Officer and Assistant Accountant (e.g. for capital items) before updating the invoice details on the purchase ledger.
- 3.74 We discussed various changes to these arrangements that were being proposed by management with the Director of Finance before a paper was presented to the Finance & Resources Committee in November 2010.
- 3.75 Following a decision to appoint new bankers (Lloyds TSB), the HPC is implementing an automated payment approval process that will replace the paper-based approval payment authorisation described above. At the time of our review the estimated implementation date for this was September 2011.

- 3.76 The second level approval will remain with Members of Council, although the threshold is to be raised to £50,000. This remains lower than the threshold in operation at most other statutory regulators of health professionals for the second tier approval by Council members. At the time of our review, these changes had not been introduced. However, when they are implemented we believe that they should not alter the effective segregation of controls over payments at the HPC and should continue to mitigate the risk of unauthorised purchases from suppliers.
- 3.77 Our sample testing indicated that controls over purchases from suppliers were operating as expected. However, the continuing use of the manual procedures alongside the automated purchase ordering processes indicates that the anticipated benefits of the PRS system are not at present being delivered in full. We raised a recommendation in relation to this matter in our previous report in November 2009.
- 3.78 We understand that some key decisions regarding the HPC's financial systems have been taken during 2010/11, which have meant that the complete automation of purchase ordering using the PRS system has not been possible. Following a review of options undertaken by the Finance Department it has been decided to align the necessary upgrade to the PRS system with a planned upgrade to the Sage financial system and the Fitness to Practise IT system. We understand that the aim of this is to ensure that the correct versions are installed to maximise the compatibility between the systems. This is scheduled to take place by September 2011.
- 3.79 Whilst we concur with this approach, we believe that it remains important that the HPC ultimately adopts a uniform process for purchase ordering and all purchase orders are ultimately to be raised on the PRS system. We have therefore re-raised our recommendation from 2009/10.

Recommendation

R2. Management should complete the steps necessary by December 2011 towards removing the option for individuals to follow manual procedures when raising supplier purchase orders.

Purchase ledger payment systems

- 3.80 Purchase ledger payments are made by BACS, manual cheque or e-banking. Payment runs are undertaken every two weeks. The Assistant Accountant prepares a Suggested Payment Run report and attaches the relevant invoices, which are reviewed by the Director of Finance who signs and dates the relevant report. The e-banking report is reviewed by the Chief Executive and Registrar. For BACS payments, a BACS form is completed and checked back to the relevant payment report before it is faxed to Natwest for processing.

- 3.81 Blank manual cheques are held securely in the safe. All cheques need to be signed by two individuals included on the HPC's bank mandate with Natwest. We noted that the bank mandate was most recently updated from 30th July 2009 as approved by the Finance & Resources Committee. We understand the bank mandate has now been amended again following our audit visit as part of the set up arrangements with the HPC's newly appointed bankers Lloyds TSB.
- 3.82 The signatories check the invoice details and the payment report before signing the cheques. We noted that manual cheques are rarely issued and are checked carefully. This should enable the HPC to mitigate the risk of forged cheques. Our sample testing indicated that these controls were operating effectively.

Main accounting and balance sheet systems

- 3.83 The HPC upgraded its financial system Sage Line 200 on 1st April 2008. A trial balance is produced routinely at month end and the HPC's income and expenditure and balance sheet items are clearly set out in the organisation's coding structure.
- 3.84 From our review of the trial balance at 30th September 2010, we noted that there was an imbalance of 6 pence. We noted a same type of difference of £1 in 2008, which was investigated by management at that time and no significant system problems or processing errors were identified as a result. We understand however that the difference has now been corrected and we have not therefore raised a recommendation.
- 3.85 The Director of Finance documents his review of the month end balances on the face of a copy of the management accounts.
- 3.86 This includes evidencing that he has checked the balances in the accounts back to source documents such as the key control account reconciliations and reports from the HPC's Fund Managers on investments. A copy of the month end trial balance is also attached.
- 3.87 The key routines that are undertaken to close down the various ledgers at month end are as follows. Before closing down the purchase ledger the Purchase Ledger Officer and Assistant Accountant confirms that there are no remaining invoices or expenses to be posted. An aged creditors report is then printed off and reviewed to ensure that no duplicate or incorrect postings have been made and checked to confirm that the total agrees to the balance recorded on the nominal ledger.
- 3.88 The HPC's income from registrants and applicants is recorded on the Netregulate system and then imported to the Sage nominal ledger in batches during the month.
- 3.89 Interface reports are produced to confirm that the transactions recorded on the Netregulate system have been correctly imported into Sage. The unused Sage sales ledger still however needs to be closed down at month end.

- 3.90 As we have previously noted, the reconciliation between the main accounting system and Netregulate was up to date at the time of our audit visit, although some months had not been performed at the start of the financial year.
- 3.91 The HPC's payroll is processed on a standalone system and journalled into the main accounting system when the pay runs have been processed. The fixed asset register is Excel based and any movements on fixed assets are also entered into the nominal ledger by journal.
- 3.92 We understand that since our on site audit visit took place, the HPC has begun to populate an integrated fixed asset module within the Sage financial system. Once the data is included in the fixed asset module and has been tested to confirm that it is operating accurately, the Excel fixed asset register will cease to be used.
- 3.93 Written procedures have been established to control the purchase and disposals of fixed assets, thereby mitigating the risk of unauthorised purchases or theft of assets.
- 3.94 Once the bank reconciliation has been completed the Sage cash book can be closed down. Bank reconciliations are prepared and reviewed on a monthly basis. Our sample testing indicated that this was the case and reconciliations had been prepared for each month and signed off as reviewed.
- 3.95 However, in order to demonstrate clearly when the review of the reconciliation has taken place, thereby evidencing that the control is in operation throughout the financial year, we believe that the Financial Controller should date as well as sign off the bank reconciliation in accordance with best practice. We have therefore raised the following recommendation.

Recommendation

R3. The review of bank reconciliations by the Financial Controller should be dated in future to evidence when the control check has taken place.

- 3.96 Finally, we noted that a suspense account is maintained as code 9999. This code is used to process any transactions that have been identified as requiring amendment or further investigation before the correct entry can be recorded. We noted that all of these items had been corrected by management on a timely basis and the balance on the suspense account as at 30th September was £Nil.

Investment management

- 3.97 As at 30th September 2010 the HPC's invested funds comprised principally £6.3 million invested in money market accounts and special interest bearing accounts with three selected banks, together with around £2 million (at market value) held under management by Rensburg Sheppards.

- 3.98 The annual fund performance is regularly reviewed by the Finance & Resources Committee in November each year, along with the Investment Policy. Our review indicated that this assessment was undertaken at the 22nd November 2010 Finance & Resources Committee.
- 3.99 The fund managers provide the HPC with a monthly investment valuation report (summary and detail) to the Financial Controller to update the valuation in the Management Accounts.
- 3.100 In our view, these regular review and reporting procedures should enable the HPC to identify and manage the impact of any fall in the value of its investment portfolio and to identify any concerns relating to the ongoing solvency and capability of its fund managers.
- 3.101 We also noted that in accordance with best practice the Finance & Resources Committee considered various options for the management of its investments at its November 2010 meeting. These included:
- ceasing using the investment funds completely and holding the funds as cash on deposit at a bank;
 - continuing with the current arrangements but tendering the fund management;
 - moving the funds currently invested and placing these into Government bonds; and
 - investigating any possible risk free and tax efficient investments.
- 3.102 We understand that a recommendation from the Finance & Resources Committee that the HPC should no longer investment in equities and bonds and hold the balance of investment funds as cash will be presented to Council in February 2011.

4 Management action plan

Ref.	Findings	Recommendations	Priority	Management Response <i>Responsible Officer</i>	Due Date
	Income systems				
R1	We understand that differences that arise (which typically amount to around £50,000 each month) relate to timing differences between receipts being recorded on Netregulate and clearing the bank account. However, we are advised that the current difference of £58,399 relates to old transactions.	Differences arising from the reconciliation between the Netregulate system and the main accounting system should be analysed and details of this should be included in the documentation to support the reconciliation. This should be undertaken during the NAO's interim audit in February 2011 and signed off by the Financial Controller when completed.	Medium	<i>Financial Controller</i> This is believed to be a historical difference, as all income reconciliations have now been reconciled. HPC to speak with NAO during the interim audit to agree that this difference can be adjusted for.	March 2011

Ref.	Findings	Recommendations	Priority	Management Response <i>Responsible Officer</i>	Due Date
	Expenditure systems				
R2	<p>We understand that some key decisions regarding the HPC's financial systems have been taken during 2010/11, which have meant that the complete automation of purchase ordering has not been possible. It has been decided to align the necessary upgrade to the PRS system with a planned upgrade to the Sage financial system. This is scheduled to take place by September 2011.</p> <p>Whilst we concur with this approach, we believe that it remains important that the HPC ultimately completes the establishment of a uniform process for purchase ordering and all purchase orders are then raised on the PRS system.</p>	<p>Management should complete the steps necessary by September 2011 towards removing the option for individuals to follow manual procedures when raising supplier purchase orders.</p>	Medium	<p><i>Director of Finance</i></p> <p>Agreed. The system changes are required for both PRS and Sage to ensure that the full benefits are realised and to ensure cross product compatibility. This should be implemented in the FY 2011/12, subject to budget approval.</p>	September 2011

Ref.	Findings	Recommendations	Priority	Management Response <i>Responsible Officer</i>	Due Date
	Main accounting and balance sheet systems				
R3	<p>Once the bank reconciliation has been completed the Sage cash book can be closed down. Bank reconciliations are prepared and reviewed on a monthly basis. Our sample testing indicated that this was the case and reconciliations had been prepared for each month and signed off as reviewed.</p> <p>However, in order to demonstrate clearly when the review of the reconciliation has taken place, thereby evidencing that the control is operation throughout the financial year, we believe that the reviewer should date as well as sign off the bank reconciliation in accordance with best practice.</p>	The review of bank reconciliations by the Financial Controller should be dated in future to evidence when the control check has taken place.	Low	<p><i>Financial Controller</i></p> <p>Agreed. All month end reconciliations are now signed and dated. The December reconciliations have been signed and dated.</p>	January 2011

5 Assurance definitions

Assurance Level	Definition
Sound	Satisfactory design of internal control that addresses risk and meets best practice and is operating as intended.
Satisfactory	Satisfactory design of internal control that addresses the main risks but falls short of best practice and is operating as intended.
Satisfactory in Most Respects	Generally satisfactory design of internal control that addresses the main risks and is operating as intended but either has control weaknesses or is not operating fully in some significant respect.
Satisfactory Except For.....	Satisfactory design of internal control that addresses the main risks and is operating as intended in most respects but with a major failure in design or operation in the specified area.
Inadequate	Major flaws in design of internal control or significant non operation of controls that leaves significant exposure to risk.