



Standing Committee (Audit and Risk)

Item 11.3 refers

Attachment 3

**Western Australian Auditor
General's Report - Management of
Supplier Master Files Report 16:
March 2019**

Western Australian Auditor General's Report



Management of Supplier Master Files



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ISSN: 2200-1913 (Print)
ISSN: 2200-1921 (Online)

WESTERN AUSTRALIAN AUDITOR GENERAL'S REPORT

Management of Supplier Master Files



**THE PRESIDENT
LEGISLATIVE COUNCIL**

**THE SPEAKER
LEGISLATIVE ASSEMBLY**

MANAGEMENT OF SUPPLIER MASTER FILES

This report has been prepared for submission to Parliament under the provisions of section 25 of the *Auditor General Act 2006*.

This focus area audit assessed whether 5 state and 5 local government entities had suitable policies, procedures and controls for the management of supplier master files, to promote effective payment processes.

I wish to acknowledge the cooperation of the staff at the entities included in this audit.

A handwritten signature in black ink, appearing to read 'C. Spencer'.

CAROLINE SPENCER
AUDITOR GENERAL
7 March 2019

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Auditor General's overview

Almost a year on from our first local government focus area audit report, I am pleased to present this Management of Supplier Master Files report which looks into state and local government entities.

Controls prevent things going wrong and are particularly important in financial management processes, where there is an inherent risk of financial misappropriation.

Our focus area audits, such as this one, look at a diverse range of entities and highlight improvement opportunities across key aspects of financial management controls.

These narrow scope audits can be considered as 'hygiene' audits as they give an indication of the health of financial management control, in this instance for both local and state government sectors.

We conduct these audits as an extension of our annual financial audits, using more detailed testing than is required for forming our financial audit opinions.

Importantly, the findings of these audits are likely representative of issues in other government entities that were not part of our sample. I encourage all entities, and not just those audited, to periodically assess themselves against these risks and controls on an ongoing basis. Our better practice checklist at Appendix 1 has been designed to assist entities to run their own hygiene checks.

Fostering understanding about the importance of strong internal control frameworks, around not only the management of supplier master files, but also areas such as procurement, information system security, and regulatory functions, will continue to be a priority in my future work.



Executive Summary

Background

In 2017-18, the Western Australian public sector paid a total of \$23 billion in operating expenses, and services and contracts. In 2016-17 local government entities reported over \$4 billion in expenditure. The vast majority of these payments were made through accounts payable systems that rely on the accuracy of information in supplier master files.

The supplier master file is a central, comprehensive file that holds information about suppliers; including method of payment, bank account details, ABN and contact details. To ensure payments are correctly made, this information needs to be valid and complete. Changes made to the supplier master file are typically varied and may include adding new or deleting redundant suppliers, changing contact or bank account details, and variations to payment frequency. Well publicised instances of fraud that have occurred in the past across Australia, and payment errors reported from our audits, demonstrate the importance of adequate control processes over changes to this information.

We previously performed this audit in 2012, for a sample of 8 state government entities. In that audit, we reported the need for those entities to improve their monitoring and review of supplier master files, and 3 needed to improve their policies and procedures for managing supplier master files.

Conclusion

Most of the 10 entities we audited did not have comprehensive policies or procedures, which resulted in a lack of formal monitoring and review of their supplier master files. More than half the entities had weaknesses in controls over creation or amendment of their supplier records. In addition, at 3 entities, some suppliers were owned by or related to employees and the entities did not adequately manage these conflicts of interest processes.

What we did

The focus of this audit was to assess whether entities had suitable policies, procedures and controls for the management of supplier master files, to promote effective payment processes.

We assessed the policies and practices at 10 state and local government entities of varying sizes over a 9-month period from 1 January to 30 September 2018. We used the following lines of inquiry:

1. Do entities have appropriate policies, procedures and controls over the creation and management of their supplier master file used in the payment process?
2. Do entities effectively implement these policies, procedures and controls?
3. Is the supplier master file operating to promote effective accounts payable processes, and reduce the risk of fraud, duplicate payments and other errors?

We tested 2,395 out of total 150,386 supplier records across 10 entities to assess if policies, procedures and controls over the supplier master files were followed, and promoted effective accounts payable processes. We also assessed how well entities managed conflict of interest in circumstances where entities procured from suppliers which were either owned by or related to their employees.

We conducted this audit under section 18 of the *Auditor General Act 2006* and in accordance with Australian Auditing and Assurance Standards.

The following 5 state and 5 local government entities were included in this audit:

Entities
City of Perth
City of Belmont
City of Busselton
City of Gosnells
Department of Finance
Department of the Premier and Cabinet
Insurance Commission of Western Australia
Public Trustee
Shire of Augusta-Margaret River
WorkCover Western Australia

What did we find?

WorkCover and the Insurance Commission displayed good policies, practices and controls. The other 8 entities need to improve various aspects of their policies and practices, in particular, management and monitoring of their supplier master files.

Most entities need to improve their policies and procedures

Sound policies and procedures help ensure that only authorised additions and changes are made to supplier master file information, and that information is accurately recorded in a consistent manner, avoiding duplicate entries.

We found that only the Insurance Commission, WorkCover and City of Gosnells had good policies and procedures featuring all the essential guidance for employees. Although the remaining 7 entities did have policies and procedures, they provided limited guidance and had the following deficiencies:

- The policies of the 7 entities did not require regular review of their supplier master files to ensure employees' compliance, validity, and completeness of the supplier records. These policies were also silent on consistent application of naming conventions when a new supplier record is created. This is important, to avoid the same supplier being created under multiple names.
- The policies of 5 entities did not require regular review of their supplier master files to identify and deactivate redundant supplier records, for example suppliers not used for more than 2 years.
- Three entities did not require recording of the reason for amendments to supplier records.
- Policies at 3 entities did not require independent review of the new supplier records created or amendments to existing supplier records. Independent review is a key control against unauthorised additions or amendments. At 2 of these entities, policies were also silent on retaining documentary evidence to support creation or amendment of supplier records.

Entities need better controls over creation and amendment of supplier records

We tested 425 newly created and existing supplier records amended from 1 January to 30 September 2018. Our objective was to assess if the internal controls implemented around creation and amendment of supplier records were appropriate and operating effectively.

The Department of Finance, Department of the Premier and Cabinet, Insurance Commission, and WorkCover demonstrated good controls over creation and amendment of supplier records. The common control deficiencies found at the other 6 entities included:

- At City of Busselton, new supplier records were created, and existing supplier records amended without an independent review. In addition, employees with the ability to create or amend supplier records could also authorise payments to suppliers. Where possible, staff who authorise payments should not also make changes to the supplier master file. At City of Belmont and City of Perth, independent review of master file updates was undertaken only on a 'spot check' basis and was limited to checking supplier bank details.

- At City of Gosnells, 44 of the 52 created and amended supplier records we tested had not been independently reviewed. At the Shire of Augusta-Margaret River, 30 of the 40 created and amended supplier records we tested were not independently reviewed.
- At the Public Trustee, 12 of 50, and at City of Gosnells 43 of 52 amendments to supplier records were made without confirming the changes with suppliers. This increases the risk of fraudulent changes passing undetected.
- At the Public Trustee and City of Perth, 37 and 12 supplier records respectively were created or amended by employees who were not authorised to do so.
- At the City of Gosnells, no documented evidence was available for 3 out of 52 supplier records created or amended.

Although we did not identify any fraudulent or erroneous transactions, the above control weaknesses increase the risk of incorrect or invalid suppliers being recorded in supplier master files. This could result in incorrect, duplicate or fraudulent payments. Also, if relevant evidence is not documented or readily available, it could be difficult for management to confirm the validity of newly created supplier records or changes to existing supplier records.

Most entities need to improve the management of their supplier master files

We reviewed the supplier master file databases for all the entities in our sample as at 30 September 2018. Our aim was to assess if the supplier master files were well managed, and were operating to promote effective accounts payable processes and reduce the risk of fraud and errors.

Only the Department of the Premier and Cabinet, Insurance Commission, and WorkCover were appropriately managing their supplier master files. The common findings at the other 7 entities were:

- Six entities had a total of 9,321 supplier records with missing information, including suppliers' bank details, ABN, address or contact details. Completeness of supplier records is essential to enable effective processing.
- Seven entities had a total of 79,107 active supplier records unused for more than 2 years. Although there may have been reasons for retaining some of these records, there was no evidence that management had identified a reason. Lack of timely clean-up or deactivation of redundant supplier records makes ongoing monitoring and review of supplier master files difficult.
- We tested 1,311 potential duplicate records and confirmed that 93 of these were duplicate supplier records, at 6 entities. These duplications were mainly due to suppliers either changing business names or bank details, but the entities did not delete or deactivate the redundant supplier records. Two of these entities also had 71 records with incorrect bank details or ABNs. Duplicate or incorrect supplier records may result in duplicate payments.

Most entities need to formally monitor compliance with their policies on a periodic basis

The Department of Finance, Insurance Commission, and WorkCover were formally monitoring their supplier master files.

Periodic review enables management to detect non-compliance with policies, remediate invalid, incomplete and obsolete supplier records, and reduce the likelihood of fraud or errors.

Conflicts of interest were not declared or effectively managed at 3 entities

Contrary to management's policies, conflicts of interest were not declared by 2 employees at the Department of the Premier and Cabinet, and 6 employees at the Shire of Augusta-Margaret River who owned, or whose family members owned the suppliers that their entity was procuring from. These potential conflicts of interests involved 14 and 29 transactions undertaken by the respective entities between April 2017 and September 2018 totalling \$41,383. The purchases included fencing, cleaning, fitness, carpentry and childcare services. We however confirmed that these employees did not approve any purchases from or payments to these suppliers.

Lack of appropriate disclosure and effective management of actual, potential or perceived conflicts of interest may undermine a fair and impartial procurement process, resulting in value for money not being achieved. Even if not involved in procurement or payment authorisation, it is important that entities' conflicts management policies are complied with.

At the City of Belmont, an employee approved 2 purchase orders totalling \$29,193 for payment of program funding to a supplier, of which the employee was a board member. An employee should not be involved in a procurement and purchasing process with a supplier they are related to. We recognise however that the employee had disclosed this conflict of interest, and that the subsequent payments were not approved by that employee.

If an employee has a conflict of interest because they are associated with a supplier, in addition to declaring the conflict, they should also not be involved in the process of procuring from that supplier.

Recommendations

1. Entities should:
 - a. have policies and procedures that include comprehensive guidance for employees to effectively manage supplier master files
 - b. ensure that all additions or amendments to supplier master files are subject to a formal independent review to confirm validity and correctness
 - c. regularly review employees' access to create or amend supplier master files to prevent any unauthorised access, and ensure adequate segregation of duties between those amending the master files and those approving payments
 - d. ensure all key information is input at the time of creating a new supplier record
 - e. apply consistent naming conventions for supplier records, to avoid suppliers being registered under multiple names
 - f. ensure that documentary evidence is retained for all additions and amendments to supplier master files and there is a record of the reason for amending the supplier record
 - g. include a requirement for a formal and periodic internal review to identify incomplete, incorrect, duplicate or redundant supplier records
 - h. ensure any actual, potential or perceived conflicts of interest are declared and effectively managed, and that relevant employees are not involved in the procurement from, or management of supplier records in respect of their related suppliers.

Response from entities

Entities in our sample generally accepted the recommendations and confirmed that where relevant, they either have amended policies and practices or will improve management of their supplier master files.

The City of Perth advised that the amendments made to 12 supplier records by employees who were not authorised to do so, were minor administration changes to the supplier file and did not impact the core supplier details.

The City of Busselton advised that it has implemented independent review of supplier master file updates.

Appendix 1: Better practice principles

The following table shows control principles on which our audit focused. They cover a number of key supplier master file practices and controls, and are not intended as an exhaustive list.

Supplier master files framework	Focus area	What we expected to see:
Policy	Policies and procedures	<ul style="list-style-type: none"> • Policies and procedures include comprehensive guidance for employees to effectively manage supplier master files. • Policies and procedures are regularly reviewed and updated.
Creation / amendments of master files	Access to master files	<ul style="list-style-type: none"> • Entities regularly review employees' access to create or amend supplier master files to reduce the risk of unauthorised changes.
	Creation	<ul style="list-style-type: none"> • Staff consistently apply naming conventions for supplier records, to avoid suppliers being registered under multiple names. • All key information is input at the time of creating a new supplier record.
	Amendments	<ul style="list-style-type: none"> • Documentary evidence is maintained to support the changes in master files. • Employee validates changes to supplier details with the supplier (i.e. via phone or formally by writing).
	Segregation of duties	<ul style="list-style-type: none"> • Additions or amendments to supplier master files are independently reviewed. • Appropriate segregation of duties is established between employees amending the master files and employees approving payments to suppliers.
	Recordkeeping	<ul style="list-style-type: none"> • Documentation is retained for all additions and amendments to supplier master files including reasons for amending the supplier details.
	Conflict of interest	<ul style="list-style-type: none"> • Employees declare any actual, potential or perceived conflict of interest. • Declarations are retained, assessed and conflicts of interest are appropriately addressed. • Employees with conflicts of interest abstain from the procurement process or managing records of the suppliers they are related to.
Management of master files	Review	<ul style="list-style-type: none"> • Management undertakes formal and periodic review of master files to identify incomplete, incorrect, duplicate or redundant supplier records. • Weaknesses identified are communicated to the relevant stakeholders and remediating actions are promptly undertaken. • The outcome of the review is presented to the audit committee.

Auditor General's Reports

Report number	Reports	Date tabled
15	Audit Results Report – Annual 2017-18 Financial Audits of Local Government Entities	7 March 2019
14	Opinions on Ministerial Notifications	13 February 2019
13	Opinion on Ministerial Notification	23 January 2019
12	Managing Disruptive Behaviour in Public Housing	20 December 2018
11	Opinions on Ministerial Notifications	20 December 2018
10	Opinions on Ministerial Notifications	18 December 2018
9	Treatment Services for People with Methamphetamine Dependence	18 December 2018
8	Opinions on Ministerial Notifications	10 December 2018
7	Audit Results Report – Annual 2017-18 Financial Audits of State Government Entities	8 November 2018
6	Opinion on Ministerial Notification	31 October 2018
5	Local Government Procurement	11 October 2018
4	Opinions on Ministerial Notifications	30 August 2018
3	Implementation of the GovNext-ICT Program	30 August 2018
2	Young People Leaving Care	22 August 2018
1	Information Systems Audit Report 2018	21 August 2018

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