

Argyll and Bute Council
Internal Audit Report
November 2018
FINAL

VAT

Audit Opinion: **Limited**

	High	Medium	Low
Number of Findings	1	2	2

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1. Executive Summary

Introduction

1. As part of the risk based continuous monitoring programme included in the 2018/19 internal audit plan approved by the Audit & Scrutiny Committee in March 2018, we have undertaken an audit of Argyll and Bute Council's (the Council) system of internal control and governance in relation to Value Added Tax (VAT). It has been conducted in accordance with relevant auditing standards.
2. The audit was conducted in accordance with the Public Sector Internal Audit Standards (PSIAS) with our conclusions based on discussions with council officers and the information available at the time the fieldwork was performed.
3. The contents of this report have been agreed with the appropriate council officers to confirm factual accuracy and appreciation is due for the cooperation and assistance received from all officers over the course of the audit.

Background

4. A taxable person must charge VAT on any taxable supply of goods or services made in the UK in the course or furtherance of any business carried on by them. A taxable person is someone that is registered or required to register for UK VAT, this can include individuals, companies, partnerships, local authorities and charities. A taxable supply is a supply of goods or services made in the UK for which a consideration is received in return, unless it is classified as being exempt from VAT.
5. The Council, as a 'taxable person' must ensure that VAT is correctly charged on the supply of goods & services. If supplies are treated incorrectly then the Council may be subject to financial penalties.
6. Schedule 33 of the 1994 VAT Act sets out special VAT rules for 'public bodies', including local authorities, in relation to the recovery of VAT incurred on expenditure relating to 'non-business' activities and on exempt business activities.
7. All parties involved in the payment/cash receipting process have a general responsibility for ensuring the effectiveness of the VAT system. The Council's Corporate Support Team is responsible for preparing and submitting the monthly return to HMRC and the Senior Business Support Officer is the key point of contact for VAT queries for all Council officers.
8. The table below shows the Council's annual VAT figures for the previous 3 financial years:

	2015/16 (£,000)	2016/17 (£,000)	2017/18 (£,000)
Value of Output Tax	901	640	804
Value of Input Tax	15,644	14,750	17,392
Net VAT Reclaimed	14,743	14,110	16,588

Scope

9. The scope of the audit was to assess the adequacy of the arrangements for compliance with HMRC VAT rules. Internal audit reviewed processes and procedures in place to test that controls, in relation to the VAT system and the classification and treatment of VAT, were in place and were operating effectively in practice.

Audit Opinion

10. We provide an overall audit opinion for all the audits we conduct. This is based on our judgement on the level of assurance which we can take over the established internal controls, governance and management of risk as evidenced by our audit work. Full details of the five possible categories of audit opinion is provided in Appendix 2 to this report.
11. Our overall audit opinion for this audit is that we can take a limited level of assurance. This means that internal control, governance and the management of risk are displaying a general trend of unacceptable residual risk above an acceptable level and placing system objectives at risk. Weakness must be addressed with a reasonable timescale with management allocating appropriate resources to the issues raised.

Key Findings

12. We have highlighted one high priority recommendation, two medium priority recommendations and two low priority recommendations where we believe there is scope to strengthen the control and governance environment. These are summarised below:
- periodic VAT sample tests should be reinstated with clarity provided over expected sample sizes
 - all new debtor charge codes requests should be subject to appropriate authorisation
 - a consistent VAT coding for payments to non-VAT registered suppliers should be identified
 - periodic consideration of the need for external VAT risk assessments should be implemented
 - additional officers should be trained in the preparation of the monthly VAT return.
13. Full details of the audit findings, recommendations and management responses can be found in Section 3 of this report and in the action plan at Appendix 1.

2. Objectives and Summary Assessment

14. Exhibit 1 sets out the control objectives identified during the planning phase of the audit and our assessment against each objective.

Exhibit 1 – Summary Assessment of Control Objectives

	Control Objective	Assessment	Summary Conclusion
1	There is an adequate control framework over access to and operation of the VAT function. The system's accuracy and effectiveness should be assessed regularly	Limited	The Business Support Officer (BSO) is tasked with undertaking various control tests to provide assurance over VAT treatment. These tests are not currently being performed due to resource issues. Clarity is also required over the sample sizes that should be tested. Weaknesses were also

			identified in relation to the VAT treatment of payments to non-vat registered suppliers and the authorisation of new charge codes in the debtors system.
2	Detailed risk assessments have been undertaken to identify and prioritise areas of risk.	Reasonable	<p>VAT risk assessments were carried out by the Council's appointed VAT advisor in 2013 and 2015 at the request of the Council. These incur additional charges as they are not provided as standard by the Council's contract with the advisors. The 2015 review, in particular, highlighted a number of areas for improvement and the Council implemented a 30 point improvement action plan to address them.</p> <p>Currently, risk reviews are only undertaken at the request of the Council. Due to the costs involved it is not recommended that external VAT risk assessments be carried out as a matter of course however strategic finance should consider implementing a process to periodically assess whether one would be beneficial.</p>
3	Appropriate controls are in place to ensure that officers adhere to legislative requirements.	Substantial	VAT returns are submitted to HMRC on a monthly basis. HMRC submission receipts are retained to evidence that claims were submitted timeously and there is evidence that claims are prepared by an appropriate officer and checked by a separate individual. Only two council officers are aware of the process for preparing the monthly VAT return. To provide greater resilience it would be advisable that at least one further officer is appropriately trained.

15. Further details of our conclusions against each control objective can be found in Section 3 of this report.

3. Detailed Findings

There is an adequate control framework over access to and operation of the VAT function

16. A VAT manual providing guidance on key areas has been created and made available to all staff via the HUB. Further VAT training, in the form of an e-learning module, is currently being created by Strategic Finance. In addition, training was provided by the Council's previous VAT advisors to key finance staff.

17. Responsibility for the inputting of financial transactions, including VAT details, is spread across a wide range of council officers and transactional systems. Consequently there is a greater risk of inconsistent or incorrect VAT coding. To minimise this risk the BSO is supposed to carry out monthly sample testing of debtors and creditors transactions to ensure the correct VAT treatment has been applied. Due to resource constraints this control has not been undertaken since September 2017. There is also a lack of clarity over the number of transactions that should be sample tested.

Action Plan 1

18. Requests to set up new codes in the cash receipting system are raised via a maintenance form which needs to be signed off by the requester's line manager and the appropriate principal accountant. These are then sent to the revenue systems administrator for action. A sample test of five requests confirmed compliance with this control. A report of all active cash receipting codes is produced on a monthly basis. From this report the BSO is supposed to check a sample with any issues reported to the system administrator. Due to resource constraints this control has not been operational since January 2018.

Action Plan 1

19. When the VAT return is prepared there is a reasonableness check which checks the amount claimed via the Council's payables reports against an audit trail report which analyses the VAT category of all transactions. There is a target to have less than 0.1% variance. If this is exceeded officers will try and identify whether any invoices have been incorrectly keyed. This will focus on any invoices which appear unusual. This, to some extent, can provide some of the sample checking which is not currently being conducted however it will only be performed if there is a concern about the overall claim.

20. Debtor charge codes can be set up for recurring debtors. When a charge code is created a default coding structure and VAT treatment is determined removing the need to input VAT details manually. There is an inconsistent approach to how officers request a new debtors charge code. Some officers request charge codes by completing a 'charge code template' and submitting their request to the debtors team for it to be actioned. There are, however, some users who have the necessary system permissions to set up a charge code themselves and who send in the charge code template retrospectively. Strategic Finance implemented a process in 2013 whereby all requests from service staff should be made using a template form which requires to be signed by both the requestor's line manager and the appropriate principal accountant. Codes should not be added without this authorisation. This process is not being complied with.

Action Plan 2

21. On a quarterly basis the BSO receives a list of all new debtor charge codes and reviews them for appropriateness. Due to resource constraints only one list has been reviewed since January 2017.

Action Plan 1

22. We sampled 30 expenditure invoices between April and June 2018 to ensure to ensure a valid VAT invoice was present, that the amount on the ledger reconciled with the invoice and the VAT category was appropriate. This identified:

- Inconsistent coding of payments to non-VAT registered suppliers. Nine such payments were in the sample with five coded as 'Exempt' and four coded as 'Zero'. The Council has previously queried this with their VAT advisor who suggested creating a new category in the general ledger specifically for payments to non-VAT registered suppliers or, if this was not possible, to categorise these as 'outside the scope'.
- One payment for ferry tickets coded as exempt, which should be zero rated.
- One payment of a council tax refund coded as exempt which should be coded as 'outside the scope'.

Action Plan 3

23. When placing orders through the PECOS purchasing system, VAT codes are automatically selected if ordering catalogue items. However if non-catalogue items are orders the VAT code is selected manually. We sampled 30 orders raised via PECOS to ensure the VAT category was appropriate and the VAT amount on PECOS reconciled with the invoice received. No issues were identified.

[Detailed risk assessments have been undertaken to identify and prioritise areas of risk](#)

24. VAT risk assessments were carried out by the Council's appointed VAT advisor in 2013 and 2015 at the request of the Council. These incur additional charges as they are not part of the contract between the Council and the advisors. The 2015 review, in particular, highlighted a number of areas for improvement and the Council put in place a 30 point improvement action plan to address these issues. The improvement plan has been fully implemented with the exception of the ongoing activity to create a VAT e-learning module referenced at paragraph 16.
25. The VAT contract was put out to tender in late 2018 and new VAT advisors have recently been appointed. Under the terms of the new contract specific risk assessments still incur an additional charge so it is not considered appropriate to recommend that external periodic VAT risk assessments be carried out as a matter of course.
26. After the completion of this review, internal audit will be including VAT testing as part of its ongoing continuous monitoring programme and report on any findings as and when they are identified. This, and the implementation of the action plan at appendix 1 to this report, should provide additional safe checks over the accuracy of VAT processing which reduces the need for external VAT risk assessments. However it would be advisable for strategic finance to implement a process to periodically assess whether an external VAT risk assessment would be beneficial.

Action Plan 4

[Appropriate controls are in place to ensure officers adhere to legislation requirements](#)

27. VAT returns are submitted to HMRC on a monthly basis. HMRC submission receipts are retained to prove they were submitted timeously. VAT returns from February to July 2018 were reviewed and it was confirmed that they were prepared, checked and authorised by different staff. Only two council officers are aware of the process for preparing the monthly VAT return. To provide greater resilience it would be advisable that at least one further officer is provided appropriate training. It is however recognised that a detailed procedure note has been created which would support the preparation of the VAT return in the event of both trained officers being absent.

Action Plan 5

28. When the VAT return is prepared there is a reasonableness check which checks the amount claimed via the Council's payables reports against an audit trail report which analyses the VAT category of all transactions. There is a target to have a less than 0.1% percentage variance. If this is exceeded then officers will do some analysis to try and identify whether any invoices have been incorrectly keyed. This will focus on any invoices which appear unusual. This, to some extent, can provide some of the sample checking which the BSO is not currently performing however it will only be performed if there is a concern about the overall claim.

Appendix 1 – Action Plan

	No.	Finding	Risk	Agreed Action	Responsibility / Due Date
High	1	<p>VAT Sample Testing</p> <p>The Council’s Business Support Officer is supposed to carry out a range of periodic sample checks to help minimise the risk of incorrect VAT treatment. These include:</p> <ul style="list-style-type: none"> • monthly checks of debtors and creditors transactions • monthly check of a sample of active cash receipting codes • quarterly check of new debtor charge codes. <p>Resource constraints have resulted in these controls not being performed. These should be reinstated and consideration given to formalising them more including establishing the sample sizes which should be checked.</p>	Failure to undertake sample testing may result in failure to identify incorrect VAT treatment leading to potential penalties imposed by HMRC.	Sample testing will be undertaken going forward.	Business Support Officer 31 January 2019
Medium	2	<p>Authorisation of Debtor Charge Codes</p> <p>There is an inconsistent approach to how officers can request a new debtors charge code. Some officers request charge codes by completing a ‘charge code template’ and submitting their request to the debtors team. There are, however, some users who have the necessary system permissions to set up a charge code themselves and who send in the charge code template retrospectively. In both instances the new charge code request is not subject to formal authorisation.</p>	Inappropriate charge codes may be set up in the debtors system which may result in incorrect VAT treatment leading to potential penalties imposed by HMRC.	Authorisation approval forms for new debtor charge codes will be re-introduced.	Revenue and Benefits Manager 31 January 2019

Medium	3	<p>VAT Coding for non-VAT Registered Suppliers</p> <p>Coding of payments to non-VAT registered suppliers is inconsistent. The Council has previously queried this with their VAT advisor who suggested creating a new category in the general ledger specifically for payments to non-VAT registered suppliers or, if this was not possible, to categorise these at 'outside the scope'.</p>	<p>Failure to ensure non VAT registered suppliers are coded correctly may result in transactions being included in the partial exemption calculation inappropriately.</p>	<p>Current process will be Investigated to identify improvements</p>	<p>Finance Manager Creditors Supervisor 31 March 2019</p>
Low	4	<p>Risk Assessments</p> <p>VAT risk assessments previously carried out by the Council's appointed VAT advisor were done at the request of the Council and incurred additional charges. The 2015 review, in particular, highlighted a number of areas for improvement and the Council put in place a 30 point improvement action plan to address those issues.</p> <p>From 2018/19 onwards, internal audit will be including VAT testing as part of its ongoing continuous monitoring programme. This should provide additional safe checks over the accuracy of VAT processing which reduces the need for external VAT risk assessments. However it would be advisable for strategic finance to implement a process to periodically assess whether an external VAT risk assessment would be beneficial.</p>	<p>Failure to take expert external advice on a periodic basis increases the risk of incorrect VAT treatment leading to potential penalties imposed by HMRC.</p>	<p>This will be considered as part of the quarterly engagement meetings with VAT Advisors</p>	<p>Head of Strategic Finance 30 June 2019</p>

Low	5	<p>Building Resilience for VAT Processing</p> <p>Only two council officers are aware of the process for preparing the monthly VAT return. To provide greater resilience it would be advisable that at least one further officer is provided appropriate training.</p>	VAT returns may be submitted late in the event of extended absence.	There is currently a restructuring within Strategic Finance that will give increased resilience and once the full establishment is in place, others will be trained in this process.	Finance Manager 30 June 2019
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In order to assist management in using our reports a system of grading audit findings has been adopted to allow the significance of findings to be ascertained. The definitions of each classification are as follows:

Grading	Definition
High	A major observation on high level controls and other important internal controls or a significant matter relating to the critical success of the objectives of the system. The weakness may therefore give rise to loss or error.
Medium	Observations on less significant internal controls and/or improvements to the efficiency and effectiveness of controls which will assist in meeting the objectives of the system. The weakness is not necessarily substantial however the risk of error would be significantly reduced if corrective action was taken.
Low	Minor recommendations to improve the efficiency and effectiveness of controls or an isolated issue subsequently corrected. The weakness does not appear to significantly affect the ability of the system to meet its objectives.

Appendix 2 – Audit Opinion

Level of Assurance	Definition
High	Internal control, governance and the management of risk are at a high standard. Only marginal elements of residual risk have been identified with these either being accepted or dealt with. A sound system of control designed to achieve the system objectives is in place and being applied consistently.
Substantial	Internal control, governance and the management of risk is sound. However, there are minor areas of weakness which put some system objectives at risk and specific elements of residual risk that are slightly above an acceptable level and need to be addressed within a reasonable timescale.
Reasonable	Internal control, governance and the management of risk are broadly reliable. However, whilst not displaying a general trend, there are a number of areas of concern which have been identified where elements of residual risk or weakness may put some of the system objectives at risk.
Limited	Internal control, governance and the management of risk are displaying a general trend of unacceptable residual risk above an acceptable level and placing system objectives are at risk. Weakness must be addressed with a reasonable timescale with management allocating appropriate resources to the issues raised.
No Assurance	Internal control, governance and the management of risk is poor. Significant residual risk and/or significant non-compliance with basic controls exists leaving the system open to error, loss or abuse. Residual risk must be addressed immediately with management allocating appropriate resources to the issues.