

# ARGYLL & BUTE COUNCIL

## Internal Audit Section

### INTERNAL AUDIT REPORT

CUSTOMER DEPARTMENT	CHIEF EXECUTIVE'S UNIT
AUDIT DESCRIPTION	RISK BASED AUDIT
AUDIT TITLE	REVIEW OF VALUE ADDED TAX 2017/18
AUDIT DATE	JULY 2017

2017/2018



## 1. BACKGROUND

This report has been prepared as part of 2017/18 risk based Internal Audit Annual Plan and has been conducted in accordance with relevant auditing standards. The report is based on discussions with key personnel and information available at the time of the Audit.

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

- Taxable person = someone that is registered or required to register for UK VAT, this can include individuals, companies, partnerships, Local Authorities and charities
- Taxable supply = a supply of goods or services made in the UK for which a consideration is received in return, unless it is exempt

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 penalties could be applicable.

S33 of VATA 1994 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.

All parties involved in the payment/cash receipting process have a general responsibility for ensuring the effectiveness of the VAT system. The Corporate Support Team is responsible for preparing and submitting the monthly return to HMRC and is the key point of contact for VAT queries for officers within the Council.

The table below shows the annual VAT figures for the previous 3 years:

	2014/15	2015/16	2016/17
<b>Value of Output Tax</b>	887	901	640
<b>Value of Input Tax</b>	17,519	15,644	14,750
<b>Net VAT Reclaimed</b>	16,632	14,743	14,110

\*Figures shown are rounded to the nearest £000

## 2. AUDIT SCOPE AND OBJECTIVES

The main objective 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.

The following control areas were reviewed as part of the audit process:

Control Objective	Control Objective Assessment
Authority - Roles and delegated responsibilities are documented in policies and procedures and are operating well in practice	Reasonable: There is no documented VAT guidance document or procedure note available although there was a recent training seminar provided by KPMG to key finance staff. Key staff are aware of role and responsibilities.
Occurrence - Sufficient documentation / audit trail exists which supports compliance with policies, procedures and relevant legislation and support VAT claims	Substantial: Supporting working papers were available for each VAT return sampled; these were comprehensive and accurate. Returns were found to be completed on a timely basis and were appropriately authorised prior to submission.
Completeness - Policies and procedures are aligned to relevant legislation and all required documentation is accurately and fully maintained in line with HMRC requirements	Limited: There is no documented VAT guidance document or procedure note available. There was a recent training seminar provided by KPMG to key finance staff.
Measurement - Systems and Processes are designed to capture relevant VAT data	Limited: VAT is a mandatory field within the systems sampled and the VAT amount is automatically calculated depending on the VAT category chosen by the user. No VAT training has been provided to staff that input into these systems.
Timeliness - Controls are in place which allow timely	Substantial: VAT returns sampled were submitted on a

capture of source data and ensure timely completion of statutory returns	timely basis. No penalties for late submission have been incurred within the period sampled.
Regularity - Documentation / System data is complete, accurate and not excessive and is compliant with the HMRC and data retention policy. It is held securely and adequate access controls are evident	Substantial: Generally, supporting VAT invoices were available for the transactions in the samples tested. The invoices available on file for one supplier did not meet HMRC VAT invoice requirements.

**3. RISKS CONSIDERED**

SRR - Risk 08: Reputation

SRR – Risk 10: Finance – Expenditure

ORR - SF01: Failure to plan, report and manage Finance, Risk and Treasury transactions.

ORR - SF02: Failure to ensure Financial and Management controls are operating effectively

Audit Risk: Failure to accurately report VAT liability to HMRC

**4. AUDIT OPINION**

The level of assurance given for this report is Reasonable.

<b>Level of Assurance</b>	<b>Reason for the level of Assurance given</b>
<b>High</b>	Internal Control, Governance and the Management of Risk are at a high standard with only marginal elements of residual risk, which are either being accepted or dealt with. A sound system of control is in place designed to achieve the system objectives and the controls are being consistently applied.
<b>Substantial</b>	Internal Control, Governance and management of risk is sound, however, there are minor areas of weakness which put some system objectives at risk and where specific elements of

	residual risk that are slightly above an acceptable level and need to be addressed within a reasonable timescale.
<b>Reasonable</b>	Internal Control, Governance and management of risk are broadly reliable, however although not displaying a general trend there are a number of areas of concern which have been identified where elements of residual risk or weakness with some of the controls may put some of the system objectives at risk.
<b>Limited</b>	Internal Control, Governance and the management of risk are displaying a general trend of unacceptable residual risk above an acceptable level and system objectives are at risk. Weakness must be addressed with a reasonable timescale with management allocating appropriate resources to the issues raised.
<b>No Assurance</b>	Internal Control, Governance and management of risk is poor, significant residual risk exists and/ or significant non-compliance with basic controls leaves the system open to error, loss or abuse. Residual risk must be addressed immediately with management allocating appropriate resources to the issues.

This framework for internal audit ratings has been developed and agreed with Council management for prioritising internal audit findings according to their relative significance depending on their impact to the process. The individual internal audit findings contained in this report have been discussed and rated with management.

A system of grading audit findings, which have resulted in an action, has been adopted in order that the significance of the findings can be ascertained. Each finding is classified as High, Medium or Low. The definitions of each classification are set out below:-

<p><b>High</b> - major observations on high level controls and other important internal controls. Significant matters relating to factors critical to the success of the objectives of the system. The weakness may therefore give rise to loss or error;</p> <p><b>Medium</b> - observations on less important internal controls, improvements to the efficiency and effectiveness of controls which will assist in meeting the objectives of the system and items which could be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified;</p> <p><b>Low</b> - minor recommendations to improve the efficiency and effectiveness of controls, one-off items subsequently corrected. The weakness does not appear to affect the ability of the system to meet its objectives in any significant way</p>
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## **5. FINDINGS**

The following findings were generated by the audit:

### **Policies & Procedures**

There is currently no documented VAT guidance document or procedure note available for staff. The Council's VAT consultant's KPMG recently delivered a VAT training seminar to key Finance Staff however training has not yet been provided to other Council staff.

### **VAT Returns**

VAT returns covering the period 2015 - 2017 were reviewed and it was found that returns were appropriately authorised prior to submission and supporting working papers were available for review. The returns sampled were submitted on a timely basis and no penalties for have been incurred for late submission within the period sampled. HMRC carry out a periodic compliance check on VAT returns where samples of working papers are reviewed for accuracy; there have been no penalties in relation to this to date.

### **Systems – Creditors**

When invoices are passed to the Creditors system, VAT details should be provided by the requester on the standard invoice stamp or should be clearly displayed on the invoice. Invoice details, including VAT treatment, are input to the system manually by creditor's staff as per the details provided by the requester. The VAT category is a mandatory field and the VAT amount is calculated automatically depending on the VAT category selected.

The Creditors supervisor attended the training seminar provided by KPMG however; other creditor team members have not received VAT training.

- A sample of 30 creditors transactions were sampled, 2 of the transactions had the incorrect VAT treatment

## **System – Debtors**

Debtor's transactions are input to the system by various staff across the Council. The debtors system has been set up with a number of charge codes, which automatically populate coding details and VAT treatment. When inputting to the system users can select a pre-existing charge code or, where a relevant charge code is not available can manually select the relevant VAT category from a drop down list.

It was noted that requests for new charge codes do not require authorisation or a secondary check for correctness before input to the system. VAT training has not been provided to staff that input into the Debtors system.

- A sample of 20 charge codes was selected and reviewed for appropriateness, there were 3 errors identified.
- A sample of 31 debtors' transactions was tested, there were 2 transactions identified that potentially have the incorrect VAT treatment.

## **System – Cash Receipting**

The cash receipting system is set up with pre-determined charging codes set up with the relevant default VAT treatments. The VAT amount is calculated automatically depending on the relevant VAT category.

Requests for alterations, deletions and additions of charge codes must be submitted to the cash receipting systems administrator on a standard request form signed by the requester's Line Manager and the relevant Principal Accountant. A record of all charge code changes is maintained by the systems administrator.

- A sample of 15 cash receipting codes was selected and reviewed for appropriateness, there were 4 errors identified.

KPMG identified 14 cash receipting codes that were set up with incorrect VAT liabilities during their last VAT review (2016). At the time of audit these had not been updated on the system.

## **Tax Point**

- The recorded tax point of a sample of 30 debtors' transactions was tested and reviewed for appropriateness; no issues were noted within the sample selected.

It was noted that there is a control mechanism in place, whereby the Business Support Officer, Treasury and Taxation, undertakes a monthly sample check of tax points and selected VAT liability prior to preparing VAT return. Any issues identified will be queried by management and/or KPMG where necessary.

## **Valid VAT Invoices**

- The debtors system generates a standard template for invoices. These templates contain the information as per HMRC's VAT invoicing requirements.
- Supplier Invoices were retrieved for a sample of 30 transactions. The invoices available on file for 26 transactions were in compliance with HMRC's VAT invoicing requirements.
- The remaining 4 transactions all related to the one supplier. The invoices available on the system for this supplier do not meet HMRC VAT invoice requirements.

## **Coding**

There are dedicated accounts codes set up for the different VAT categories. Transactions that are categorised as zero rated, exempt and out with scope are all coded to the same account code.

- It was noted that payments made to non-VAT registered suppliers are currently coded to one of the '0' categories (zero rated, exempt or out with scope). Application of this was not consistent.
- KPMG has advised that a separate account code should be set up where possible for non-VAT registered suppliers, if this is not possible then these transactions should be categorised as 'out with scope'.



## **Correction Process**

There is no process in place, following identification of an error/incorrect VAT treatment, which ensures that each of the financial systems are updated with the correct information.

## Observations

We have also highlighted to management the following observation(s) which have been identified during the review. Although not included in the scope the matter was brought to auditor attention during the audit and either indicates a potential risk exposure and /or could be considered as a matter of good practice and therefore noted for information and completeness:

- VAT returns are generally completed by the one individual. At the moment, there is a secondary member of staff who can cover when necessary. Management should give consideration to ensuring continuity of cover for this process in the future.
- There are 5 VAT codes available for selection within the Debtors system, one of which is 'Non-Business'; this category relates to transactions that are 'out with the scope' of VAT. This terminology is inconsistent with the VAT categories in the other systems.

## **6. CONCLUSION**

This audit has provided a Reasonable level of assurance as Internal Control, Governance and Management of risk are broadly reliable, however although not displaying a general trend there a number of areas of concern which have been identified. There were a number of findings identified as part of the audit and these, together with agreed management actions, are set out in the attached action plan. There were 5 actions which will be reported to the Audit Committee. Progress with implementation of actions will be monitored by Internal Audit and reported to management and the Audit Committee.

Thanks are due to the Corporate Support staff and management for their co-operation and assistance during the Audit and the preparation of the report and action plan.

**APPENDIX 1 ACTION PLAN**

<b>Findings</b>	<b>Risk Impact</b>	<b>Rating</b>	<b>Agreed Action</b>	<b>Responsible person agreed implementation date</b>
<b>1. Guidance/Procedure Note</b>		<b>High/ Medium</b>		
There is no documented VAT guidance/procedure note available for staff.	Failure to provide formal guidance and procedures may lead to incorrect VAT treatment/ reporting resulting in penalties and fines from HMRC.	High	<b>VAT Documentation will be prepared and issued.</b>	<b>Finance Manager, Corporate Support  31 December 2017</b>
<b>2. VAT Training</b>				
VAT training has not been delivered to all staff involved in determining VAT treatment.	Failure to promote VAT awareness and provide training to staff may lead to incorrect VAT treatment/reporting resulting in penalties and fines from HMRC.	Medium	<b>VAT training in the format of an e-learning module will be prepared to allow Argyll and Bute specific training to be delivered.</b>	<b>Finance Manager, Corporate Support  31 March 2018</b>
<b>3. System – Cash receipting</b>				
Cash receipting codes identified by KPMG as having incorrect VAT treatment had not been updated at the time of	Failure to ensure errors are corrected on a timely basis may result in ongoing incorrect VAT treatment/reporting	Medium	<b>The corrections will be implemented.</b>	<b>Finance Manager, Corporate Support  31 October 2017</b>

audit.	resulting in penalties and fines from HMRC.			
<b>4. Systems</b>				
From samples tested, there were a number of errors in relation to incorrect and inconsistent VAT treatment identified across the different systems.	Inconsistent / incorrect practice may lead to incorrect VAT treatment/reporting resulting in penalties and fines from HMRC.	Medium	<p><b>Sample testing will continue and any inconsistencies will be addressed.</b></p> <p><b>The correct treatment will be emphasised in the VAT training being prepared</b></p>	<p><b>Finance Manager, Corporate Support</b></p> <p><b>30 September 2017</b></p>
<b>5. Valid VAT invoices</b>				
Invoices held on file for one supplier do not comply with HMRC's VAT invoice requirements.	Failure to retain appropriate evidence to support VAT recovery may lead to failure to reclaim VAT from HMRC resulting in financial loss for the council.	Medium	<p><b>The issue of the invoices in respect of this supplier has been addressed.</b></p> <p><b>The HMRC requirements for an invoice will be included in the VAT training.</b></p>	<p><b>Finance Manager, Corporate Support</b></p> <p><b>31 March 2018</b></p>



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