

INTERNAL AUDIT REPORT

FROM: Audit and Risk Manager **SUBJECT:** VAT Accounting

TO: Head of Finance **DATE:** 30 September 2013
Strategic Finance Manager

C.C. Chief Executive
Deputy Chief Executive (AJ)
Principal Accountant (MM)
Assistant Accountant (GW)

1. INTRODUCTION

- 1.1. In accordance with the Audit Plan for 2013/14, Ian Wilson, Senior Internal Auditor, has completed an examination of the above subject area and this report presents the findings and conclusions for information and action where applicable.
- 1.2. Wherever possible, results obtained have been discussed with the staff involved in the various procedures examined and their views are incorporated, where appropriate, in any recommendations made. My thanks are extended to all concerned for the help and co-operation received during the audit.

2. SCOPE AND OBJECTIVES OF AUDIT

- 2.1. The purpose of the examination was to report a level of assurance on the adequacy of controls in place to ensure that VAT is accounted for completely and correctly and that claims arising are processed promptly.
- 2.2. The examination comprised an evidential risk-based review of structures and processes in place under following themes:
- § roles and responsibilities;
 - § policies and procedures;
 - § monitoring and review.
- 2.3. The findings are based on discussions with relevant staff and examination of documents and records (including application of data analytics as appropriate). The principal contact for the assignment was Gary Walker, Assistant Accountant.

3 FINDINGS

3.1 Recommendations From Previous Report

- 3.1.1. The status of the recommendations from the previous review reported in December 2010 is as follows:

Recommendation	Status
1 The second member of staff able to prepare and submit the monthly return should be instructed to be able to submit the return on line.	A second Assistant Accountant has been instructed and is now routinely involved on the VAT return process.
2 The monthly return should be prepared and submitted by another member of staff at least annually.	An occasional rotation has been established with the second Assistant Accountant referred to above. At the time of the audit, this officer had last taken a turn preparing the January 2013 return.
3 In the longer term The VAT manual should be reviewed, updated and relaunched in order to provide guidance to staff on the administration of VAT.	The latest update was re-launched in January 2013 with e-mail circulation by a Deputy Chief Executive.
4 In the meantime the VAT manual on the intranet should be repositioned onto the Finance Home Page.	A suitably prominent link to the VAT Manual is located on the Finance Page of the Intranet.
5 The spreadsheet containing details of the VAT treatment of income should be issued to senior managers for them to forward to relevant members of their staff.	The spreadsheet was circulated to Service Area Managers by e-mail in late 2011.

3.2 General Observations

3.2.1 VAT is a tax on transactions that affects a substantial proportion of entries in the accounting system and its administration is an important part of main accounting operations. In 2012/13 the total Council's input tax (i.e. VAT portion of payments made) was around £5.7 million and output tax (VAT portion of income received) was around £2.3 million. The latter figure includes a large recovery of retrospective output tax arising from a special HMRC assessment, and a more typical annual total would be nearer £1.5 million.

3.2.2 The vast bulk of the input and output totals emanate from transactions which rely substantially on automated processing within two major systems:

§ Total financial management system (FMS)

§ Paris income management system.

For this reason, the main focus of assurance testing has been on the relevant transaction flows within these systems, while taking into account a measure of external assurance provided by the National Fraud Initiative in respect of creditor payments.

3.2.3 There has been one major change since the previous audit - standard rate increase from 17½ per cent to 20 per cent from January 2011. While it is not within the scope of this examination to assess the processes to deal with these changes, the evidence seen indicates that the processes have been successful in absorbing them.

3.3 Roles and Responsibilities

3.3.1 While there is no single source that defines the hierarchical structure of roles and responsibilities in its entirety, the key elements can be gleaned from sources that include the Code of Financial Practice, Finance Risk Register and the job description of the applicable Accountancy post.

3.3.2 Key provisions in the Code of Financial Practice include:

§ the responsibility of Corporate Management Team in controlling the accounts and finances under the general direction of Council and Executive;

§ responsibilities of the Head of Finance for the administration of financial affairs covering (among other provisions) determining accounting formats/procedures, advising corporately on tax issues and instructing and advising on VAT administration.

3.3.3 From here, two distinct hierarchical flows emerge. On a general day-to-day basis, the Code of Financial Practice places clear responsibilities on Heads of Service and budget managers on ensuring correct VAT treatment on all income and expenditure transactions within their service and budget heads. The other flow is illustrated in the Finance Risk Register which vests risk ownership relating to key VAT administration matters in the Strategic Finance Manager.

3.3.4 The final piece of the jigsaw is represented by the role of the Assistant Accountant post. The most up to date job description available from Human Resources provides for taking a lead role in any of a series of specialisms including VAT. Although this version dates back to 2007, and changes to the post references have occurred from the recent restructure of Finance, it is expected that the above specialism provisions still hold good.

3.3.5 The principal contact for the audit referred to above has carried this lead role for a number of years. More recently, a second Assistant Accountant has become involved on a routine basis to improve resilience in case of continuity risks materialising.

3.4 Policies and Procedures

- 3.4.1 Nationally VAT is subject to an array of rules and regulations to such an extent that there is little that local policies can usefully add beyond provisions on accounting arrangements, in particular system configurations that fully or partially automatic VAT treatment at transaction level.
- 3.4.2 Certain elements of policy are contained in the Codes of Financial Practice and Procurement Practice. In the former, there is an express requirement for creditor invoices to be checked for 'appropriate VAT details' (referring to the information inclusions required for a valid 'tax invoice'). The latter contains provisions on ordering goods and services that encourage the raising of purchase orders in Total, thereby invoking the system's parameters which automatically calculate expected VAT. This in turn has to be agreed with the invoice arising.
- 3.4.3 In terms of day-to-day procedures, the main sources are the training notes for the Purchase Order, Invoice Processing and Debtors modules of Total, along with a corporate VAT Manual. All these are published on the Council's Intranet for reference by all staff as needed.
- 3.4.4 Another key reference is the spreadsheet listing VAT treatment for income itemised under cost centres and subjective headings that are subject to regular income transactions (through Paris and/or Total Debtors). This is designed to inform VAT treatment settings in the Paris and Total (periodic income) systems and for reference when raising individual debtor invoices in Total.
- 3.4.5 This spreadsheet formed the basis of data exception testing on treatment of income processed through Paris and Debtors. The test used data matching to highlight inconsistencies between correct VAT treatment, as stated in the spreadsheet, and actual treatment evidenced by current year transaction data. Where there were no matches, the transactions were reviewed by ledger code to confirm that VAT treatment was consistent with VAT rules as understood from brief research.
- 3.4.6 The overall outcome was to confirm that the relevant system configurations and procedures effectively ensure correct VAT treatment of income. A small number of anomalies were found which were referred to the Assistant Accountant for investigation, as were a small number of cases from the non-matches showing recent code changes and possible useful additions for the next update of the spreadsheet. A small incidence of debtor accounts showing inconsistencies has been addressed by individual query with the originators. The impact of the anomalies in overall monetary terms is not significant.
- 3.4.7 Testing on creditors focused on gaining assurance that checking processes are effective in ensuring that reclaims of VAT are supported by valid tax invoices. This was done by random sample from all invoices over a recent 12 month period.

- 3.4.8 The test revealed a few deviations - further checks on other invoices from the suppliers in question showed these to be isolated cases for the most part. There was a minor issue arising from observations on invoices from Warwickshire County Council - only the facing pages were being scanned of when the supplier address (a required detail on a valid tax invoice) is now shown exclusively on the reverse. This has been addressed in informal discussions with the Financial Administration Manager and DMC Team Leader with agreement that any printed content on the reverse of single sheet invoices is to be scanned along with the main pages (at least on a trial basis).
- 3.4.9 The test outcome gives due assurance on general compliance with HMRC requirements, but the deviations preclude any meaningful substantive assurance for the population (i.e. the maximum deviation percentage for the population at a given level of confidence).
- 3.4.10 The remaining transaction source with significant impact on the overall VAT figures is the journal entry. The bulk of these relate to adjustments of VAT forming part of regular reallocations of cash and bank income from holding codes to their correct headings. These apply to in particular to Royal Spa Centre functions (including bar/catering takings), car parking charges and sport and leisure establishments.
- 3.4.11 An analytical review of the journal line transactions in the VAT account, in conjunction with other testing described above, highlighted a contrast in approach between the Royal Spa Centre and the other categories. Paris is configured to post Spa Centre income without VAT split, whilst at the same time splitting VAT at standard rate for car parking and sport and leisure.
- 3.4.12 The upshot of this is that accounting for output VAT on Spa Centre income relies entirely on manual journals, whereas in the other categories journals are used only to adjust back output VAT on income from non-taxable service elements. Discussion with the Assistant Accountant involved in allocating Spa Centre income served to confirm the impression that this configuration has applied since the original implementation of Paris and has never been formally challenged as to the reason behind it.

Risk

Significant under-declaration of output VAT may arise in periods where there is a backlog of Spa Centre income allocations due to other priorities.

Recommendation

The feasibility of re-configuring Paris to automatically split VAT from Spa Centre bankings should be investigated.

- 3.4.13 For the purpose of this audit, an analytical review of VAT journals over a five year period was preferred over transaction testing. This did not raise any areas of concern - in categories where there were significant fluctuations in VAT adjustment amounts, these were shown to be in line with overall income fluctuations.

3.4 Monitoring and Review

- 3.5.1 The visible elements of monitoring and review are manifest in the processes of VAT return preparation (monthly) and 'partial exemption' calculation (yearly).
- 3.5.2 Figures for the VAT return are substantially drawn from reports generated in Total, which serves to reinforce the importance of 'getting it right' at transaction level. Standard checks on the reports include identifying VAT inputs with transaction types other than those associated with trade creditor payments – these are verified individually against supporting information.
- 3.5.3 On completion, the summary spreadsheet supporting the VAT Return is printed and signed off by the person preparing the return and by the person checking. Usually it is the main audit contact who prepares the return and the second Assistant Accountant who checks the entries, although this is occasionally reversed (most recently in for the January 2013 return). Re-performance tests on a sample of returns over the last year did not discover any anomalies.
- 3.5.4 The 'partial exemption' calculation uses a spreadsheet model and the results are published in the VAT Manual with previous years' results for comparison. This continues to show the proportion of input tax from relating to exempt activities to be comfortably below the threshold.
- 3.5.5 Other elements of monitoring indicated in the Finance Risk Register include scrutiny of Executive reports and Finance representation on project boards. A general watching brief is maintained with the aid of a subscription update service and liaison with other authorities.
- 3.5.6 Recent developments in evidence include:
- § a voluntary disclosure which led to the HMRC assessment and retrospective payment in March 2013 of output tax on shared parking enforcement service costs (since recouped from Warwickshire County Council);
 - § participation in a consortium of local authorities mounting a legal challenge to the requirement to tax sports facilities income.

4 CONCLUSIONS

- 4.1 The examination has concluded that a sound control framework is established for the VAT accounting operations based on clearly defined roles and responsibilities underpinned by robust policies and procedures with appropriate monitoring and review processes.
- 4.2 Some minor issues arose from testing in depth, although these are not of such significance as to detract from the above conclusion and most have been addressed in consultations with relevant staff.

- 4.3 The one area that warrants closer management attention is the inherent configuration in Paris that caused Royal Spa Centre income to be posted without separation of VAT, in contrast with other major income generating activities.
- 4.4 Notwithstanding the above, we are able to give SUBSTANTIAL assurance that the structures and processes operate effectively to manage the applicable risks.
- 5 MANAGEMENT ACTION
- 5.1 There is one recommendation arising which is reproduced in the appended Action Plan for management response.

Richard Barr
Audit and Risk Manager