

INTERNAL AUDIT REPORT

FROM: Audit and Risk Manager
TO: Head of Finance
C.C. Chief Executive
Deputy Chief Executive (AJ)
Strategic Finance Manager
Assistant Accountant (GW)
Portfolio Holder – Cllr. Hales

SUBJECT: VAT Accounting
DATE: 7 May 2020

1 Introduction

- 1.1 In accordance with the Audit Plan for 2019/20, an examination of the above subject area has been completed recently and this report presents the findings and conclusions for information and action where appropriate.
- 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 Background

- 2.1 Value Added Tax (VAT) is a subject highly familiar to businesses, the general consumer and the accountancy profession. It is complex to administer requiring effective financial systems, key staff with a measure of specialist understanding and checks and controls over financial operations throughout the Council.
- 2.2 As a substantially public-funded organisation, the Council is a net receiver of refunded VAT from Her Majesty's Revenues and Customs (HMRC) that in the last financial year amounted to around £5½ million. To receive this the Council must meet a raft of legislative obligations, the most crucial of which include:
- being registered for VAT;
 - submitting monthly returns in the form and method determined by HMRC within strict deadlines;
 - maintaining proper accounts and supporting records.

3 Scope and Objectives of the Audit

- 3.1 The audit examination was undertaken for the purpose of reporting 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.

3.2 The examination took the form of an evidential overview of the structures and processes for administering VAT in the context of the following themes:

- roles and responsibilities
- policies and procedures
- monitoring and review.

3.3 The findings are based on discussions with a range of contacts, primarily with Gary Walker (Assistant Accountant) and on examination of relevant documents and records supplemented by analysis of financial data.

4 Findings

4.1 Recommendations from previous report

4.1.1 The current position in respect of the recommendations from the audit reported in June 2016 is as follows:

Recommendation	Management Response	Current Status
1 A set of clear instructions should be compiled for the application of VAT free use of council facilities and issued to all relevant managers. <i>(Low risk)</i>	The relevant VAT Guidance contains clear criteria on when VAT exemption can be applied to the letting of sports facilities. This will be used to provide clear guidance to managers.	This issue in question has been overtaken by events in the form of the outsourcing of sport and leisure management.
2 The monthly VAT return should be prepared and submitted by another member of staff at least annually. <i>(Medium risk)</i>	Agreed. The Assistant Accountant responsible for checking the return has prepared it in the past but not on a regular basis. The frequency will be formalised going forward.	It was confirmed from enquiry that this is being applied.
3 The VAT Reference Manual should be reviewed and publicised with an Intranet notice. <i>(Low risk)</i>	Agreed.	An updated version of the VAT Manual was launched in February 2019.
4 Staff should be encouraged to refer routine queries to the Assistant Accountant. <i>(Low risk)</i>	Agreed. Staff will be made aware of this via the intranet when the VAT Manual is relaunched.	

4.2 **Developments since the last audit**

4.2.1 The prioritisation of areas to review under the audit have been partly influenced by the following developments that occurred since the last audit:

- HMRC's 'Making Tax Digital' programme extended to VAT;
- on-line payment facilities extending to Council services subject to VAT;
- auto-matching of creditor invoices;
- project started to replace the Total FMS and Paris Income Management System in progress with implementation scheduled for April 2021.

4.2.2 In the light of the system replacement project, testing of controls was primarily by process walkthrough as distinct from computer-aided transaction level testing that had been performed in the past.

4.2.3 The report takes note of two voluntary disclosure cases since the previous audit where input tax claimed on VAT returned had to be repaid to HMRC. One from 2016 related to invoicing error by the construction contractor (the amount concerned was subsequently recovered from the contractor so there was no financial loss to the Council).

4.2.4 The other case is recent and gives rise to a retrospective compliance check by HMRC concerning VAT treatment of election costs. The check was ongoing at the time of the audit.

4.3 **Roles and Responsibilities**

4.3.1 The mapped hierarchy of responsibilities for VAT takes in elements of the Constitution, especially provisions of the Scheme of Delegation and Code of Financial Practice. There has been no noticeable change in this hierarchy since the previous audit.

4.3.2 At day-to-day administrative level, the role placements come from the specialism provisions of the generic Assistant Accountant job description with some enhancements in the Finance Risk Register. The designated post holder for the VAT specialism remains unchanged since the previous audit, as does the designation of a colleague Assistant Accountant to cover the role with provision for taking occasional turns in preparing the VAT returns.

4.4 **Policies and Procedures**

4.4.1 VAT on income (output tax)

It goes without saying that the Council is registered for VAT and there is an obligation to ensure that the VAT registration number appears as standard on relevant invoices rendered and receipts for payment of taxable goods services provided (among other prescribed information).

4.4.2 Traditionally, compliance with this had been tested in audits by examination of specimen sundry debtors' invoices, cash income system-generated receipts and pre-printed manual receipt books. It became evident on this occasion, however, that paper receipts are now well eclipsed in importance as a consequence of Digital Transformation.

- 4.4.3 To give some indication as to where this test should be focused, a profile analysis of output tax generated from income transactions was performed. Based on current year output tax postings (expected to total over £1½ million) the significant source components that make this up are shown below with the percentage of output tax represented by each:
- | | |
|---|-----|
| Car park on-site (card and cash) | 40% |
| Car park season tickets (telephone payments) | 4% |
| Sundry Debtor Invoicing | 27% |
| Royal Spa Centre (shows and bar purchases) | 11% |
| Building Control (telephone and on-line payments) | 9% |
| Garage Rents | 6% |
- 4.4.4 The VAT portions of Spa Centre income and garage rent charges have to be allocated by journal entry based on periodic returns from their respective source processing systems. Sundry debtor invoices are posted directly within the Total FMS while the remaining elements are posted daily via interfaces with the Paris income management system with VAT at standard rate automatically split out based on in-built parameters.
- 4.4.5 Compliance with VAT Regulations (per 4.4.1 above) was again tested by examination of specimen invoices/receipts but focusing on the above listed elements (ultimately this had to exclude the Royal Spa Centre). The only areas raising questions over compliance related to building control fees and garage rents.
- 4.4.6 VAT is charged on garages only where the tenant is not a Warwick District housing tenant or where an individual housing tenant is renting more than two garages from the Council's stock (in which case only two of those garages would be free of VAT).
- 4.4.7 The review failed to find evidence that garage tenants are being supplied with any documentation that quotes the Council's VAT number. In this case the issue is an essentially technical one - the tenancy conditions preclude the possibility of tenants running a VAT-registered business in such a way that the rental VAT element could be legitimately reclaimed from HMRC as input tax. In discussion with the Business Manager (Housing Services) it was agreed that the VAT registration number can be added to the tenant statement template and this was left as an informal suggestion.
- 4.4.8 The situation with building control fees is of more concern as a significant proportion of customers can be businesses with legitimate right themselves to reclaim VAT on fees as input tax. In fact, there have been reported cases where the Council has been unable to supply properly constituted tax invoices when requested by such customers (this is addressed in practice by a follow-up confirmatory e-letter quoting the Council's VAT number to supplement automatic e-receipts generated at the time of the transaction).
- 4.4.9 The issue relates primarily to fees payable at the time of plan submission (subsequent fees known as inspection fees are raised by sundry debtor invoice although it is evident in some cases that payment of this fee may be rendered without being so invoiced).

- 4.4.10 From the auditor's own understanding of 'tax invoice' requirements, specimen e-receipts examined showed that those generated for payments via the online portal are constituted validly as acceptable tax invoices for transactions of not more than £250 but not for higher amounts. For telephone payments, the e-receipts generated show as satisfying the full tax invoice detail requirements but for one crucial omission – the Council's VAT registration number.
- 4.4.11 The findings here suggest a degree of reputational risk with potential adverse impact on the Building Control Consortium's ability to maximise its income in a competitive environment. The severity of the issue can only be assessed by further detailed investigation with expert input on technological considerations as well as VAT compliance.

Risk

The Council may be viewed as not fulfilling its obligations to customers in respect of VAT compliance.

Recommendation

VAT compliance in respect of e-receipting by the Council's on-line payment portals and systems processing telephone payments should be investigated.

- 4.4.12 VAT Guidance
The Council still maintains an internal VAT Guidance Manual which is generally accessible in the Intranet via the Finance Team pages. The Manual was updated and re-launched in February 2019.
- 4.4.13 VAT Accounting Framework
The basic accounting structures and transactional processing streams are unchanged from the last audit, subject to a shift in traffic away from internally processed receipting towards greater use of bank and internet streams.
- 4.4.14 The key to correct accounting for input tax remains the processing of creditor invoices with adequate checks that they meet regulatory criteria for valid tax invoices. This process has become more centralised with the advent of invoice auto-matching. In the light of the current major system replacement project, it was decided not to perform the traditional sample tests on invoices at this juncture.
- 4.4.15 VAT Returns
The process flows involved in compiling the Council's monthly VAT returns are unchanged from the last audit, subject to latter-stage enhancements to account for anomalies that started to arise from the advent of invoice auto-matching and to meet the HMRC's 'Making Tax Digital' requirements. A walkthrough of the process for a recent month revealed no issues.

4.5 **Monitoring and Review**

- 4.5.1. Annual checks continue to be undertaken for ensuring that the Council remains below the 'de minimis' of 5 per cent of input tax claimed attributed to VAT-exempt activity.
- 4.5.2 A review of the Finance Risk Register confirmed that the control of VAT-related risks is given due profile and that the mitigation and control activity represented stands up to scrutiny. This is subject to some minor anomalies of detail which have been raised informally.

5 **Conclusions**

- 5.1 Following our review, in overall terms we are able to give a SUBSTANTIAL degree of assurance that the systems and controls overall in respect of VAT accounting are appropriate and are working effectively.
- 5.2 The assurance bands are shown below:

Level of Assurance	Definition
Substantial Assurance	There is a sound system of control in place and compliance with the key controls.
Moderate Assurance	Whilst the system of control is broadly satisfactory, some controls are weak or non-existent and there is non-compliance with several controls.
Limited Assurance	The system of control is generally weak and there is non-compliance with the controls that do exist.

- 5.3 The only issues to emerge are concentrated on VAT compliance in the operation of the Council's on-line payment portals and systems processing telephone with particular attention drawn to building control fees. The issues raised are not deemed conclusive in themselves and warrant further detailed investigation.

6 **Management Action**

- 6.1 The single recommendation arising above is reproduced in the attached Action Plan (Appendix A) for management attention.

Richard Barr
Audit and Risk Manager

Action Plan

Internal Audit of VAT Accounting - March 2020

Report Ref.	Recommendation	Risk	Risk Rating*	Responsible Officer(s)	Management Response	Target Date
4.4.11	VAT compliance in respect of e-receipting by the Council's on-line payment portals and systems processing telephone payments should be investigated.	The Council may be viewed as not fulfilling its obligations to customers in respect of VAT compliance.	Medium	Head of Finance	Work with the Housing Services Team and Building Control teams (with potential IT support) to implement process to ensure compliance.	September 2020

* Risk Ratings are defined as follows:

High Risk: Issue of significant importance requiring urgent attention.

Medium Risk: Issue of moderate importance requiring prompt attention.

Low Risk: Issue of minor importance requiring attention.