

ABERDEEN CITY COUNCIL

COMMITTEE	Audit, Risk and Scrutiny Committee
DATE	25 September 2018
REPORT TITLE	Internal Audit Report AC1906 – VAT
REPORT NUMBER	IA/AC1906
DIRECTOR	N/A
REPORT AUTHOR	David Hughes
TERMS OF REFERENCE	2.2

1. PURPOSE OF REPORT

- 1.1 The purpose of this report is to present the planned Internal Audit report on VAT.

2. RECOMMENDATION

- 2.1 It is recommended that the Committee review, discuss and comment on the issues raised within this report and the attached appendix.

3. BACKGROUND / MAIN ISSUES

- 3.1 Internal Audit has completed the attached report which relates to an audit of VAT.

4. FINANCIAL IMPLICATIONS

- 4.1 There are no direct financial implications arising from the recommendations of this report.

5. LEGAL IMPLICATIONS

- 5.1 There are no direct legal implications arising from the recommendations of this report.

6. MANAGEMENT OF RISK

- 6.1 The Internal Audit process considers risks involved in the areas subject to review. Any risk implications identified through the Internal Audit process are as detailed in the attached appendix.

7. OUTCOMES

- 7.1 There are no direct impacts, as a result of this report, in relation to the Local Outcome Improvement Plan Themes of Prosperous Economy, People or Place, or Enabling Technology, or on the Design Principles of the Target Operating Model.
- 7.2 However, Internal Audit plays a key role in providing assurance over, and helping to improve, the Council's framework of governance, risk management and control. These arrangements, put in place by the Council, help ensure that the Council achieves its strategic objectives in a well-managed and controlled environment.

8. IMPACT ASSESSMENTS

Assessment	Outcome
Equality & Human Rights Impact Assessment	An assessment is not required because the reason for this report is for Committee to review, discuss and comment on the outcome of an internal audit. As a result, there will be no differential impact, as a result of the proposals in this report, on people with protected characteristics.
Privacy Impact Assessment	Not required
Duty of Due Regard / Fairer Scotland Duty	Not applicable

9. APPENDICES

- 9.1 Internal Audit report AC1906 – VAT.

10. REPORT AUTHOR DETAILS

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ABERDEEN CITY COUNCIL

Internal Audit Report

VAT

Issued to:

Steven Whyte, Director of Resources
Sandra Buthlay, Interim Chief Officer - Finance
Fraser Bell, Chief Officer - Governance
Carol Smith, Accounting Manager
Lesley Fullerton, Finance Operations Manager
External Audit

EXECUTIVE SUMMARY

VAT is a tax that is charged on most goods and services that VAT-registered businesses provide in the UK. When VAT-registered businesses buy goods or services they can generally reclaim the VAT they have paid. The Council is required by law to make periodic VAT returns to HM Revenue and Customs (HMRC). In 2017/18 the Council reclaimed £60.6 million of VAT.

The objective of this audit was to provide assurance over arrangements in place to maximise the recovery of VAT and ensure that VAT recovered is adequately supported.

Clear procedures are in place for the preparation of VAT returns and staff involved in the preparation of returns are adequately trained. However, procedures lacked explanation on when VAT codes should be used, and Finance has agreed to make written procedures available to staff, who process creditor and debtor invoices, describing the correct use of VAT codes.

Business records were found to adequately support VAT recovered. However, purchases were overstated on the April 2018 VAT return by £1.7 million. This did not have any impact on the VAT claimed but resulted in a reporting error. The Service has agreed to put an independent review of VAT returns in place, agreeing the return to the supporting reconciliation spreadsheet and ledger prior to submission.

If input VAT on exempt activities is less than 5% of the Council's total input VAT, the Council can recover this VAT. The Council is correctly recovering this VAT, however, it was noted that the exempt VAT is not forecast during the financial year, in order to establish whether the 5% threshold might be exceeded. If this were exceeded, it would result in a reduction of recoverable input VAT of approximately £3 million per annum. Finance has agreed to prepare an exempt supply input VAT forecast once the budget has been agreed, in addition to the current calculation at year end.

VAT returns were being submitted in a timely manner, and VAT relating to bad debt write offs and election expenditure was found to be in accordance with HMRC guidance. There were no outstanding matters in relation to the most recent HMRC visit in June 2017.

1. INTRODUCTION

- 1.1 VAT is a tax that is charged on most goods and services that VAT-registered businesses provide in the UK. When VAT-registered businesses buy goods or services they can generally reclaim the VAT they have paid. In 2017/18 the Council reclaimed £60.6 million of VAT.
- 1.2 The Council is required by law to make periodic VAT returns to HM Revenue and Customs (HMRC). VAT returns are compiled by Finance from data contained in the Council's financial management system eFinancials and are submitted to HMRC electronically on a monthly basis.
- 1.3 The objective of this audit was to provide assurance over arrangements in place to maximise the recovery of VAT and ensure that VAT recovered is adequately supported.
- 1.4 The factual accuracy of this report and action to be taken with regard to the recommendations made have been agreed with Carol Smith, Accounting Manager, Lesley Fullerton, Finance Operations Manager and James Boulton, Accountant.

2. FINDINGS AND RECOMMENDATIONS

2.1 Written Procedures

- 2.1.1 Comprehensive written procedures which are easily accessible by all members of staff can reduce the risk of errors and inconsistency. They are beneficial for the training of current and new employees and provide management with assurance of correct and consistent practices being followed, especially in the event of an experienced employee being absent or leaving.
- 2.1.2 Clear and comprehensive written procedures are in place for the preparation of the VAT return, including screenshots of eFinancials and the related reconciliation spreadsheet which must be completed.
- 2.1.3 The Council's Finance Regulations, approved by Council in March 2018, state VAT must be applied in compliance with VAT legislation and advice on the correct VAT treatment may be obtained from the Council's VAT Accountant. They detail the VAT codes to be used and when errors are required to be reported to HMRC. The Debtors Guide also notes the requirement to account for VAT when raising debtor invoices. However, policy and procedures lacked explanation on when the available VAT codes should be used. Including common examples of when to use codes would reduce the risk of VAT being accounted for incorrectly, particularly in relation to charges without VAT, where a choice is required between zero rated, outside the scope of VAT, and exempt.

Recommendation

Written procedures should be made available to staff, who process creditor and debtor invoices, describing the correct use of VAT codes.

Service Response / Action

Agreed.

Implementation Date

December 2018

Responsible Officer

VAT Accountant

Grading

Significant within audited area

- 2.1.4 The Service keeps up to date with current legislation through attendance at the CIPFA Local Authority VAT Consultative Group. The group meets 3 times each year and the VAT Accountant attended the most recent meeting in May 2018, where a range of VAT issues and HMRC guidance were discussed. A contract is also in place with PricewaterhouseCoopers to answer specific VAT queries.

2.2 Access Control over the Council's Online VAT Account

- 2.2.1 The Council submits VAT returns electronically using the Government Gateway online account. Access to the online account is restricted by user name and password. The VAT Accountant and four additional members of staff have access to the account, enabling the VAT return to be submitted in the VAT Accountant's absence. A random six digit access code is required to access the account, which is sent automatically by HMRC to the VAT Accountant's telephone, located within Finance, when a user attempts to log in.

2.3 Business Records

- 2.3.1 VAT Regulations require that business records are retained and should be sufficient to satisfy HMRC should they conduct an audit. Business records include annual accounts, bank statements, debtor and creditor invoices, orders and details of cash collected.

- 2.3.2 Output VAT on supplies should be accounted for by local authorities within 2 months of the date of supply, at the earliest of the debtor invoice date, and when payment is made. VAT on invoices issued by the Council has to be included in the VAT return within 2 months of supply or a VAT return error will occur due to the delay, which may need to be reported separately to HMRC, and can lead to interest and penalties. VAT on creditor invoices should be reclaimed on receipt of a compliant VAT invoice.
- 2.3.3 The Council accounts for VAT on debtor and creditor invoices based on the date of input to the respective systems. Cash received by the Council is recorded in the Icon cash receipting system and VAT is accounted for in the cash receipting system when received.
- 2.3.4 A sample of 40 creditor invoices, 20 debtor invoices and 20 cash receipting transactions, covering all VAT codes, was reviewed, to ensure VAT was accounted for correctly. The creditor and debtor invoices were also reviewed to ensure the invoices complied with VAT regulations and had been processed in a timely manner. This was found to be the case with the exception of 2 creditor invoices without VAT, 1 coded as zero rated when it should have been outside the scope of VAT and another coded as outside the scope of VAT when it should have been zero rated. In these cases, although the coding was incorrect the amount of VAT accounted for was correct. A recommendation to issue procedures on VAT coding has already been made at paragraph 2.1.3 above.

2.4 Reconciliations

- 2.4.1 The VAT return is created by extracting information from eFinancials and the cash receipting system using Business Objects (BOXI). The reports currently in use capture all required transactions and are considered adequate.
- 2.4.2 The top ten creditors invoices with and without VAT are reviewed, with copies of invoices obtained and any errors are adjusted by journal or manually in the reconciliation spreadsheet where there is no impact on VAT reclaimed. While no errors were noted in the coding of the top ten creditor invoices with VAT, three coding errors were noted in the top ten invoices without VAT. A recommendation to issue guidance on VAT codes has already been made above. No further creditor invoices are reviewed, on the basis the onus to charge VAT correctly is on the supplier, since any errors on VAT invoices are recovered by HMRC from the supplier.
- 2.4.3 The VAT return for April 2018 was reviewed and all sources of income and expenditure had been accounted for, with the VAT control accounts for input and output VAT per the ledger agreeing to the VAT return reconciliation and the figures per the VAT reconciliation agreeing to the VAT return.
- 2.4.4 Whilst figures could be clearly agreed to the ledger, manual adjustments had been applied on the face of the VAT reconciliation, which fed through onto the April 2018 VAT return. Two of the three creditor invoice coding errors referred to in paragraph 2.4.2 were identified by the VAT Accountant as being outside the scope, instead of zero rated, as per the creditors system. However, the adjustment was applied incorrectly, meaning purchases were overstated on the VAT return by £1.7m. This did not have any impact on the VAT claimed but resulted in a reporting error.
- 2.4.5 It was noted that the VAT Accountant prepares and submits VAT returns in the absence of a documented review. A review by a Finance colleague to confirm the accuracy of the VAT reconciliation and figures entered on the VAT return, would reduce the likelihood of errors in the return.

Recommendation

A copy of the online VAT return should be agreed to the reconciliation spreadsheet and ledger, by a member of Finance not involved in the preparation of the return, before submission.

Service Response / Action

Agreed.

Implementation Date

December 2018

Responsible Officer

Finance Operations
Manager

Grading

Significant within audited
area

2.5 Submission

2.5.1 The deadline for submission of VAT returns is the end of the first week of the month following the month of the return i.e. the return for August must be submitted by 7 October. Failure to submit the VAT return on time could result in a penalty and delays receipt of the VAT claimed. The February 2018, March 2018 and April 2018 returns were tested and found to have been submitted to HMRC timeously, and in advance of the prescribed due date.

2.6 Exempt VAT

2.6.1 The Council is entitled to reclaim all input VAT relating to its exempt activities, provided the input VAT relating to exempt supplies does not exceed 5% of the total input VAT in the financial year. An annual calculation is undertaken to confirm this. The calculation for financial year 2016/17 was reviewed to confirm the Council's exempt VAT position. The exempt VAT position was less than 5% of total input VAT, meaning the Council was entitled to reclaim all input VAT in 2016/17. The 2017/18 calculation is due to be completed by the first week in November 2018 when the September 2018 VAT return is due.

2.6.2 It was noted that the input VAT is not forecast during the financial year. The VAT Accountant advised that consideration was taken of large projects during the year, such as the AECC development, and their impact on exempt supplies and input VAT recovery. Documenting these considerations in a regular forecast would reduce the risk of financial loss due to exempt supply input VAT exceeding the 5% threshold. This loss would be at least £3.3m based on 5% of 2017/18 input VAT.

Recommendation

The Service should introduce a regular exempt supply input VAT forecast.

Service Response / Action

Agreed. Finance has agreed to prepare an exempt supply input VAT forecast once the budget has been agreed, in addition to the current calculation at year end.

Implementation Date

March 2019

Responsible Officer

VAT Accountant

Grading

Significant within audited
area

2.7 Bad Debt Relief

2.7.1 When VAT'able goods or services are sold to a customer, the VAT element is paid to HMRC. If the customer does not pay some or all of the amount due, the VAT that was charged and paid to HMRC can be reclaimed; this is termed bad debt relief. Claims for

bad debt relief can be made, when the debt is written off and the debt has remained unpaid for a period of 6 months and not longer than 4 years and 6 months, after the later of when payment is due and payable and the date of the supply.

- 2.7.2 VAT relating to write offs accounted for in the April 2018 VAT return was reviewed to ensure they complied with these conditions. All write offs related to debts older than 5 years of age and no VAT had been reclaimed for these invoices in accordance with HMRC regulations.

2.8 Reviews by HMRC

- 2.8.1 HMRC undertook a review of the Council's VAT records and returns in June 2017. Requests were made for additional information in June 2017 and August 2017 by HMRC, including staff guidance on processing invoices, a list of asset disposals and details of Council ALEOs, which were provided by the VAT Accountant. An error was identified in relation to the sale of land in 2014 which had been opted to tax, for which VAT of £16,667 had not been paid by the Council to HMRC in error. The VAT and interest owed was deducted by HMRC from the amount claimed in the September 2017 VAT return.

2.9 Elections

- 2.9.1 HMRC internal manual VATGPB8680 advises that because local authorities are under a statutory duty to provide a Returning Officer, they can recover any VAT incurred in connection with local elections under s33 of the VAT Act. VATGPB8680 goes on to state as a result of s27 of the Representation of the People Act 1983, the office of a Returning Officer is distinct from the Council, in relation to general elections, by-elections, and European elections, meaning VAT is not recoverable for goods or services from sources other than the Council for these elections.
- 2.9.2 Expenditure relating to the June 2017 general election and the May 2017 local government election was reviewed. VAT was treated in accordance with HMRC guidance.

AUDITORS: D Hughes
A Johnston
N Ritchie

Appendix 1 – Grading of Recommendations

GRADE	DEFINITION
Major at a Corporate Level	The absence of, or failure to comply with, an appropriate internal control which could result in, for example, a material financial loss, or loss of reputation, to the Council.
Major at a Service Level	<p>The absence of, or failure to comply with, an appropriate internal control which could result in, for example, a material financial loss to the Service/area audited.</p> <p>Financial Regulations have been consistently breached.</p>
Significant within audited area	<p>Addressing this issue will enhance internal controls.</p> <p>An element of control is missing or only partial in nature.</p> <p>The existence of the weakness identified has an impact on a system’s adequacy and effectiveness.</p> <p>Financial Regulations have been breached.</p>
Important within audited area	Although the element of internal control is satisfactory, a control weakness was identified, the existence of the weakness, taken independently or with other findings does not impair the overall system of internal control.