



Internal Audit Report
Corporate and Democratic Services
IR 35
Assignment No 17- 21
February 2018

Final Report

Legal and Governance
Corporate and Democratic Services
Perth & Kinross Council
Council Offices
2 High Street
Perth
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Internal Audit

“Internal Audit is an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes”. Public Sector Internal Auditing Standards (PSIAS)

The Council’s Audit Committee approved the PSIAS as the relevant standard for its Internal Audit activity.

Background and Introduction

This audit was carried out as part of the audit plan for 2017/18, which was presented to the Audit Committee on 27th September 2017. Audit testing was carried out in January and February 2018.

A change in the law means the Council must engage with individual contractors in a specific way from 6th April 2017. This new legislation is often referred to as [IR 35](#). The legislation places a direct responsibility upon all public bodies to ensure that the employment status of all Contractors is correctly assessed.

IR35 specifically refers to Contractors who set up Personal Service Companies in order to avoid or minimise paying income tax and Class 1 National Insurance Contributions, but IR 35 equally applies to partnerships or sole traders or some limited companies.

Off-payroll working rules (IR 35) are in place to make sure that, where an individual who would have been an employee if they were providing their services directly, pay broadly the same tax and National Insurance Contributions as an employee. If the rules apply, the public authority, agency or other third party who is responsible for paying the worker’s intermediary must deduct tax and Class 1 National Insurance Contributions and report them to HM Revenue and Customs (HMRC).

Scope and Limitations

The purpose of this audit is to provide assurance over compliance with processes for the HMRC guidance known as IR35.

In order to arrive at an opinion on the achievement of the control objective, the audit will include interviews with staff and review of documentation. Arrangements within external bodies such as joint boards are excluded from the scope of this audit.

Control Objectives and Opinions

This section describes the purpose of the audit and summarises the results. A ‘control objective’ is a management objective that requires the maintenance of adequate and effective internal controls to ensure that it is achieved. Each control objective has been given a rating describing, on the basis of the audit work done, the actual strength of the internal controls found to be in place. Areas of good or poor practice are described where appropriate.

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Control Objective: To provide assurance over Service compliance with processes for the HM Revenue and Customs (HMRC) guidance known as IR35

Audit Comments:

This report gives moderate assurance over Service compliance regarding processes for the HM Revenue and Customs (HMRC) guidance known as IR35. The new requirements have been subject to a transitional period and whilst none of the findings were deemed financially material, there is a need to review the procedures and related controls.

At the introduction of the process, to help ensure compliance with the IR35 requirements, the Service advised that they reviewed their existing suppliers taking action to identify those potentially captured by the legislation. Discussions were facilitated at all SMT's and some Divisional Management Teams, correspondence was issued to authorised signatories to help raise awareness, and meetings arranged with those Services that had requested further information.

Procedures have been issued that detail the routines to be followed to comply with the HMRC IR35 guidance. Testing revealed scope to review these procedures to reflect actual working practice and also ensure that other employment guidance materials are removed or updated to be better aligned with these procedures.

Managers are required to send predetermined documentation to the Financial Systems team including cases assessed as a) self- employed or b) employed and paid via the payroll, with income tax and national insurance deductions made as appropriate. Sample testing of cases processed by the Payroll team confirmed deductions have been made.

Differences were found when comparing cases listed in the Financial Systems team log as being paid via the payroll to information provided by the Payroll team.

Sampling of 20 separate suppliers and sundry creditor information to the log confirmed that copies of the HMRC toolkit outcome were held for these cases, but 1 toolkit submitted by a Service was completed incorrectly.

Testing of the assessed employment category for 20 cases highlighted 1 missing toolkit form.

Procedures state that no payment can be made until a contractor declaration has been signed and forwarded to the Service. Testing revealed that of the 176 entries on the log 10 stated "waiting on Contractor Declaration", however £6,600 of invoices had been paid in respect of 2 of these 10 cases.

Testing of 10 declarations revealed 3 cases where the contractor signature box was not signed, but the name was typed. There is scope to clarify which staff are authorised to sign such declarations. The Service advised the use of the declaration was to assist with in-house procedures and was not a HMRC requirement.

Strength of Internal Controls:

Moderate

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Management Action and Follow-Up

Responsibility for the maintenance of adequate and effective internal controls rests with management.

Where the audit has identified areas where a response by management is required, these are listed in Appendix 1, along with an indication of the importance of each 'action point'. Appendix 2 describes these action points in more detail, and records the action plan that has been developed by management in response to each point. Appendix 3 describes one action point which, although outwith the scope, was considered of sufficient importance as to be brought to Management's attention.

It is management's responsibility to ensure that the action plan presented in this report is achievable and appropriate to the circumstances. Where a decision is taken not to act in response to this report, it is the responsibility of management to assess and accept the risks arising from non-implementation.

Achievement of the action plan is monitored through Internal Audit's 'follow up' arrangements.

Management should ensure that the relevant risk profiles are reviewed and updated where necessary to take account of the contents of Internal Audit reports. The completeness of risk profiles will be examined as part of Internal Audit's normal planned work.

Acknowledgements

Internal Audit acknowledges with thanks the co-operation of the Financial Systems team during this audit.

Feedback

Internal Audit welcomes feedback, in connection with this audit or with the Internal Audit service in general.

Distribution

This report will be/ has been distributed to:

B Malone, Chief Executive

J Valentine, Depute Chief Executive and Chief Operating Officer

S Mackenzie, Head of Finance

K Donaldson, Corporate Human Resources Manager

S Walker, Chief Accountant, Finance Division

L Simpson, Head of Legal & Governance

K McNamara, Head of Strategic Commissioning and Organisational Development

G Taylor, Head of Democratic Services

E Sturgeon, HR Manager

K Ridley, HR Manager - Strategy

C Robertson, Central Services Manager, Finance Division

L Law, Financial Systems Team Leader, Finance Division

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V Iwanio, Employment Services Team Leader

C Judge, Team Leader Resourcing

External Audit

Authorisation

The auditor for this assignment was D McCreadie. The supervising auditor was M Morrison.

This report is authorised for issue:

Moirra Morrison
Senior Internal Auditor
Date: February 2018

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Appendix 1: Summary of Action Points

No.	Action Point	Risk/Importance
1	Assessing Employment Status Procedures	Medium
2	Contractor Declaration	Medium
3	IR 35 Supporting Documentation	Medium
4	Short Term Resourcing Toolkit	Medium

Appendix 3: Incidental Action Point

5	Short Term Resourcing Toolkit	Medium
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Appendix 2: Action Plan

Action Point 1 - Assessing Employment Status Procedures

There is scope to update procedures to refer to the use of consultants who could be captured by the IR35 rules and also reflect current working practice. For example procedures require a Manager to obtain assurance from an agency that the contractor has been assessed as self-employed or payments made through their payroll. In practice however, the Service has written to larger agencies informing them that the default will be that the agencies will pay their workers through their payroll. The Service advised that based on HMRC guidance they have deemed that certain categories of workers are outside the IR35 requirements, such as those where a substitute worker would be accepted but procedures don't reflect this.

The title of the procedures excludes the words IR35 which may make it less easy to appreciate that they detail the off-payroll IR35 requirements. The guidance states they replace the "Guidance for Self Employed Status" but this guidance needs to reflect the new IR35 process. Procedures include an "Agency" section which states more information to follow.

There is scope to utilise a version control system to help evidence that the correct version is being used. The lack of easily available up to date, consistent procedural guidance could lead to the misinterpretation of requirements.

Management Action Plan

- a) The Assessing Employment Status Procedures will be updated for approval by the Central Services Manager and renamed to include the title self-employed /IR 35 and updated to reflect working practice, for example the use of agency workers, consultants and detail the categories of workers deemed to fall outside the IR35. The changes will be actioned via an announcement on the Finance Information Zone and a Financial Controllers update to cascade to their service.
- b) The Guidance for Self Employed Status on the A-Z Eric pages will be updated to include the new IR35 process.
- c) A version control system will be introduced which records the author/ approver or date issued /next review date.

Risk/Importance:	Medium
Responsible Officer:	C Robertson, Central Services Manager
Lead Service:	Corporate and Democratic Services
Date for Completion (Month / Year):	June 2018
Required Evidence of Completion:	a) Updated procedures that have been appropriately approved and circulated b) Confirmation that guidance has been updated c) Extract from version control

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Auditor's Comments

Satisfactory

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Action Point 2 - Contractor Declaration

Assessing Employment Status procedures states that no payment can be made until a contractor declaration has been signed and retained by the Financial Systems team centrally, for HMRC audit purposes. 10 of 176 entries on the log stated "waiting on Contractor Declaration". However, just over £6,000 had been paid in respect of invoices for 2 of these cases. In addition, the hyperlink to the contractor declaration in the procedures did not work.

There is scope to clarify who is authorised to sign the above forms as procedures are entitled "for the attention of authorised signatories". The procedures require Managers to assess declarations. A review of 10 forms found some were signed by authorised signatories and others by Managers. The signature boxes on 3 of these forms were not signed by the contractor but their names typed.

The Service advised that the use of a declaration was to assist with in house procedures and not an HMRC requirement.

Management Action Plan

The Service will review the use of and layout of the Contractor Declaration form(s) after input from the relevant parties. The Assessing Employment Status procedures will be thereafter updated to include action if no contractor signature. The updated procedures will include a working hyperlink and state that these forms need be signed by each Service prior to submission to the Financial Systems Team.

Risk/Importance:	Medium
Responsible Officer:	C Robertson, Central Services Manager
Lead Service:	Corporate and Democratic Services
Date for Completion (Month / Year):	June 2018
Required Evidence of Completion:	Updated contractor declaration procedures clarifying action taken if not in order and who can sign.

Auditor's Comments

Satisfactory

Action Point 3 - IR 35 Supporting Documentation

The Service maintains a log that includes cases where HMRC deductions should be made. Differences were found when comparing entries on this log to information provided by the Payroll team. Whilst this meant that deductions were made, this would indicate that the Services are not following procedures.

Also, 2 cases in the log were not included in the information held by the Payroll team; this meant that contrary to procedures these invoices were paid without income tax or national insurance deductions. The Service advised these related to final payments for concluded contracts during the transitional period. These totalled £1,200 which was not deemed financially material. The Service could not provide a copy of the HMRC toolkit outcome for 1 of these 2 cases.

Testing of 20 HMRC toolkit records highlighted 1 further case assessed as employed for tax purposes on the HMRC toolkit but recorded on the IR35 log as self-employed. This contractor was paid £160 outside payroll. The Service advised this contractor was self-employed and the HMRC toolkit completed wrongly by the submitting Service.

There is scope for the Service to formalise their processes to sample test supplier and creditor information to the IR35 log to ensure workers are properly assessed.

Management Action Plan

a) The Senior Financial Systems Development Officer will liaise with the HR officer (General Payroll) to agree an ongoing process which ensures that both the Payroll team record and the IR35 logs agree. Where differences are found each case will be discussed with the individual services on a case by case basis to resolve.

b) A process will be implemented whereby the Senior Financial Systems Development Officer reviews the assessment of contractors by sample testing a selection of supplier and creditor information to the IR35 log taking action as appropriate.

c) The "self-employed" case on the IR35 log will be updated to be recorded as employed with the missing HMRC toolkit outcomes case put on hold and new form obtained if required.

Risk/Importance:	Medium
Responsible Officer:	A Craig, Senior Financial Systems Development Officer
Lead Service:	Corporate and Democratic Services
Date for Completion (Month / Year):	June 2018

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Required Evidence of Completion:	<ul style="list-style-type: none">a) Copy of process that checks both IR35 log and Payroll team records agree.b) Copy of oversight process that sample tests the assessment of contractors.c) Completed
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Auditor's Comments

Satisfactory

Action Point 4 - Short Term Resourcing Toolkit

A short term resourcing toolkit document, dated March 2015, refers to procedures relating to contractors for example, the self-employed and agencies. However, the toolkit makes no reference to the IR35 requirements although contractors could be subject to these requirements. Para 6.3 of the toolkit includes a “how to guide” which opens a link to “Guidance for Self Employed Status” but the Assessing Employment Status procedures (as referred to in Action Point 1) stipulate that they replace this guidance which should not be used. The Service advised the toolkit was in the process of being updated and refreshed.

The Short Term Resourcing page on Eric includes a category of “Agency Worker”, with a “how to resource an agency worker” link. This opens a procedure with no reference to the IR35 requirements for example requiring a Manager to determine that an agency has appropriately assessed the worker.

Management Action Plan

The short term resourcing toolkit pages on Eric will be updated to include reference to the Assessing Employment Status procedures by the Senior Human Resources Officer in liaison with Senior Financial Systems Development Officer, Financial Services.

The “Guidance for Self Employed Status” routines will be updated on Eric and the [How to Resource with an Agency Worker](#) link from the “Agency Worker” category on the Short Term Resourcing page will be updated to also refer to the IR35 requirements.

Risk/Importance:	Medium
Responsible Officer:	P Nicoll, Senior Human Resources Officer
Lead Service:	Corporate and Democratic Services
Date for Completion (Month / Year):	June 2018
Required Evidence of Completion:	Updated Eric short term resourcing toolkit and how to resource with an agency worker referring to IR 35.

Auditor's Comments

Satisfactory

Appendix 3: Action Plan

Action Point 5 Data Protection Paragraph

Incidental to audit testing the Auditor noted that the contractor declaration as referred to in Action Point 2 requires responses to some information that is not used to process all contractor invoices but only those processed by the Payroll team. However, this may be a breach of the third data protection principle which requires personal data to be adequate, relevant and not excessive in relation to the purpose for which they are processed.

The data protection paragraph is on the opposite side of the declaration which is also after the contractor's signature which may make it less easy to demonstrate that the contractor had been made aware of the content of this paragraph.

Management Action Plan

The Senior Financial Systems Development Officer, Financial Services will review the additional information on the contractor declaration form with a view to this information only being requested from those contractors where the information is required (those classed as employed)

The data protection paragraph on the declaration will be moved to be closer to the contractor's signature.

Risk/Importance:	Medium
Responsible Officer:	C Robertson, Central Services Manager
Lead Service:	Corporate and Democratic Services
Date for Completion (Month / Year):	June 2018
Required Evidence of Completion:	Updated contractor declaration(s) and extract from updated procedures.

Auditor's Comments

Satisfactory