

## **Payroll Key Controls and IR35 2017-18**

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Cabinet Member: Cllr Mandy Chilcott

Division and Local Member:

### **Audit Opinion was split into 2 categories**

Payroll Key Controls – Reasonable

IR35 – Partial

This report is in respect of the IR35 opinion only although it should be noted that HR Admin and Payroll (HRAP) are part of the audit programme most years and have not received a rating below reasonable for many years.

## **1. Background Information**

In April 2017 new legislation was introduced requiring the Public Sector to assess whether workers, provided via an intermediary and up until this point paid outside of payroll, would have been subject to PAYE if not paid via the intermediary. The intermediary could be their own personal services company, an agency or a third party paying the intermediary. The legislation is called “Off Payroll Working in the Public Sector” but is commonly referred to as IR35.

The legislation applied to payments made on or after 6<sup>th</sup> April 2017 and therefore contracts in place prior to this date, but continuing to operate or invoices settled after it, had to be reviewed along with all new ones.

- 1.1. The HMRC final guidance and toolkit to support the assessment of employment status was issued well into 2017 and there was national debate on the legislation implementation date being delayed to allow more time for Public Bodies to prepare for the implementation. This was not agreed.

Responsibility for managing the change in process and assessing any vendors who may fall into the requirements was given to the Strategic Manager in HR Admin and Payroll, but there was close working between Procurement, Exchequer Services and HR.

- 1.2. One member of HR worked on this project almost full time from the beginning of February 2017 and for several months afterwards. The ongoing assessment of workers who may be covered by this legislation and knowledge sharing with Council and School employees continues to be a key part of her role.

## **2.0 Update following Audit Opinion**

Since the audit, processes have continued to be developed and actions taken to address the weaknesses identified. An update to the recommendations is provided below in each recommendations action plan section and labelled Update September 2018.

**1. IR35 (off payroll working rules):** The Council is liable for additional tax and NI deductions, penalties and interest due to non-compliance with IR35 regulations.

**1.1 Identification of affected suppliers**

In anticipation of forthcoming changes to off-payroll working rules for public sector bodies, all strategic, service managers and schools were contacted by HR Admin & Payroll to provide details of potentially affected suppliers to HR Admin & Payroll for assessment. 1,541 lines of data were received initially, and as of November 2017 an additional 235 suppliers have been referred for assessment. The HR Admin & Payroll team reported in February 2018 that 34 assessments are currently outstanding. It should however be noted that to comply with the legislation, the status of particular types of supplier will require regular reassessment depending upon the type of work they are doing, and the personnel used to perform this work.

We were advised during this review that there was no review of the council's contract register to identify suppliers potentially affected by the legislation. Some initial work to review known vendors in the financial management system (SAP) was completed in relation to 174 vendors identified through the process explained above, however this did not result in any vendors being blocked (a status which ensures no payments can be processed). HR Admin & Payroll and Finance representatives confirmed that no comprehensive review of vendors has been completed in respect of IR35 due to the substantial number of vendors on SAP (noted to be approximately 30,000), and because it is not possible to apply a blanket block without completing additional checks for each vendor. A review is undertaken by the Exchequer team periodically to block vendors that have not been used in more than two years, but the most recent exercise was before the IR35 legislation changed in April 2017.

On this basis a decision has been made to review suppliers as they engage with SCC. However, if supplier affected by IR35 exist in SAP and have not been blocked, there is a risk they will be paid without necessary tax deductions being made. A specific risk exists around invoices which are successfully three-way matched, as these invoices will be paid without any intervention from the Exchequer team.

During the review we saw evidence that both the Commercial & Procurement and Exchequer teams have referred suppliers to HR Admin & Payroll for assessment as these have been set up or invoices received. However, without a suitable control to reduce the risk posed by existing suppliers, there is a risk that payments will not be processed in accordance with the legislation and this could lead to SCC becoming liable for relevant income tax and NIC charges.

**1.1a Proposed Outcome: Priority 4**

We recommend that the Service Manager – Chief Accountant and Strategic Manager – HR Admin & Payroll identify a suitable method to limit the risk posed by existing vendors. This could include blocking of vendors that have not been used since the IR35 legislation was updated to prevent payments being made to them without a tax status assessment.

**Action Plan:**

<b>•Person Responsible:</b>	Lizzie Watkin	<b>•Target Date:</b>	<b>•In progress</b>
<b>• Original Management Response:</b>	<p>•The Finance team are starting a full review of all vendors that have not been paid prior to a certain date. This is expected to result in many hundreds of vendors being blocked. This is however not as straight forward as just applying the block as open purchase orders and other activities need to be considered and managed at the same time. Once complete it has been agreed that the list collated by the HR Admin and Payroll team as part of the initial personal service company data collection exercise will be matched to the remaining vendors. It is anticipated that this will show that the vendors who have required</p>		

<b>Update September 2018</b>	<p>payment since April 17 were reviewed when they were re-engaged or invoices were processed.</p> <ul style="list-style-type: none"> <li>• As at 15/05/2018 we had 49,891 vendor records, of which 17018 were blocked. The recent cleanse process looked at 13158 vendors who had not been used during the last 2 years and 9059 were blocked. A further review is about to commence to reduce open vendors further.</li> </ul>
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**1.2 Record of assessments**

The primary method for collating data received from officers, monitoring assessment progress and recording assessment results has been the use of spreadsheets. Review of the spreadsheets identified that they have not always been completed in a consistent manner and hence could not be easily analysed. For instance, in one spreadsheet there is a 'assessment status' column for which the answers 'yes' and 'no' refer to whether Exchequer performed a check to see if they had any transactions in the previous twelve months, while the same column is used to determine whether assessments have been completed or are pending. We were advised that the spreadsheets have developed over a period of several months and not all entries have been reviewed as more columns had been added.

We were informed during the review that there is an intention to share a list of assessed suppliers with services via SharePoint. There is a risk that a lack of clarity in source documentation could result in incorrect information being provided to service areas, or affected suppliers not being identified for assessment, meaning they may not be paid in the manner required by off-payroll working rules.

**1.2a Proposed Outcome: Priority 3**

We recommend that the Strategic Manager - HR Admin & Payroll Services ensures that supporting spreadsheets are reviewed to ensure that assessment status and results have been clearly and consistently recorded.

**Action Plan:**

<b>•Person Responsible:</b>	Rachel Ellins	<b>•Target Date:</b>	<b>•Complete</b>
<b>•Original Management Response</b>  <b>Update September 2018</b>	<ul style="list-style-type: none"> <li>•HRAP are now using a One Note workbook to record and store information relating to assessment status and results in a clear and consistent manner</li> <li>•Processes have continued to be developed and the use of OneNote has enabled all information to be held in one place with simple search and retrieval process.</li> <li>•Assessed suppliers have not been shared widely because the terms of each engagement often differ and therefore each contract needs to be considered in its own right.</li> <li>•We also now block some vendors, who we have identified as potentially providing in scope services, after each invoice is processed to ensure that payment is reviewed.</li> </ul>		

**1.3 Appeals procedure**

We received evidence that standard letter templates have been prepared for agencies, partnerships, sole traders and personal service companies for notifying suppliers of the new legislation and their tax status assessment results. Each of the templates confirms that the recipient can challenge their assessment result by writing to HR Admin and Payroll Services.

There is no documented appeals procedure, though through testing we observed that a common process is in place. Challenges from suppliers are also referred to in draft guidance yet to be issued to service managers (see 1.4) and while this confirms HR Admin and Payroll will provide support for any challenges, this does not outline an appeals procedure.

Without a documented procedure, there is a risk that managers will not understand the procedure and hence the appeals process will not be applied consistently across the organisation, which could lead to complaints from suppliers.

1.3a Proposed Outcome: Priority 3

We recommend that the Strategic Manager - HR Admin and Payroll Services introduces a documented procedure for IR35 assessment appeals; and that this is shared amongst all managers who will be responsible for completing tax status assessments.

**Action Plan:**

●Person Responsible:	Rachel Ellins	●Target Date:	●Complete
●Management Response:	<p>●Our decision letter does include details of who to contact if you do not agree with the decision. The process that follows is dependent on any additional information supplied but ultimately the status decision sits with the engager and the legislation supports this. The legislation does require us to put in writing why we have made the decision we have within 31 days of receiving a challenge, but generally we provide this information when informing the worker of our status decision if we believe them to be subject to the legislation. The guidance has been enhanced.</p> <p>●The appeals continue to be managed centrally to ensure consistency due to the complex legislation and low volumes.</p>		
<b>Update September 2018</b>			

1.4 Resource available for completing assessments

The HR Admin & Payroll service holds responsibility for the completion of tax status assessments for existing and new suppliers. As explained under 1.1, managers and school officers were asked to identify any known suppliers who could be impacted by the legislation, and a considerable number were identified.

The HR Admin & Payroll service was previously part of Southwest One. When this contract ended in late 2016, staff who had been employed by SCC and seconded to Southwest One were returned to SCC employment, but there was an overall reduction in resource as other staff returning to other partners.

We have found that though there have been instances of officers outside of the HR Admin & Payroll service completing assessments, the majority have been completed by one officer in this team. This officer was selected due to them previously being responsible for similar assessments for self-employed suppliers. However, we were informed during this review that managers could cover these responsibilities in the short term but there is not sufficient knowledge of the legislation within the service to cover in the long term.

In the event of long term absence, there is a risk that tax status assessments will not be completed correctly or within reasonable timeframes. Subsequent delays in releasing payments to suppliers could result in cessation of services and reputational damage.

1.4a Proposed Outcome: Priority 3

We recommend that the Strategic Manager - HR Admin & Payroll Services reviews arrangements for completing tax status assessments to ensure there is sufficient cover available.

<b>Action Plan:</b>			
●Person Responsible:	Rachel Ellins	●Target Date:	●In progress
●Management Response <b>Update September 2018</b>	●Additional resource has already been introduced to support the process and an additional colleague will also be trained soon. ●Additional staff are now able to provide advice in relation to the process, review the engagements and sign off the decisions.		

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**1.5** ●Authorisation of assessment decisions

We completed testing on a sample of assessments to establish whether there was evidence of senior officer review and authorisation of assessment decisions. Our testing established that evidence of authorisation was in place for only five of the 15 supplier assessments reviewed.

Discussion with officers confirmed that there is no standard authorisation process and that, depending on the results of the tax status assessment, authorisation is not always required. For instance, if an assessment identifies that a supplier should be paid through the payroll system, this is discussed but not formally signed off. Though we were informed that all results are at least discussed, without documented authorisation there is no evidence to show this. Without documented evidence there is a risk assessments results may not be correct, and this could mean suppliers that tax and National Insurance deductions are not made where required by law.

**1.5a** Proposed Outcome: **Priority 3**

We recommend that the Strategic Manager - HR Admin and Payroll Services ensures there is consistent process by which all tax status assessments are reviewed and authorised. This process should also incorporate authorisation requirements for tax status assessments undertaken outside of HR Admin and Payroll.

**Action Plan:**

●Person Responsible:	Rachel Ellins	●Target Date:	●Complete
●Management Response:  <b>Update September 2018</b>	●The team are now using One Note to store or link to correspondence relating to assessments and decisions. As part of this the One Note page is notated by the HRAP authoriser following discussion with the processor. Assessments undertaken for Reed appointments, that are outside of IR35 are checked prior to instructing Reed, by HRAP and when assessments are undertaken by managers the results will be reviewed, where necessary challenged, and then stored in HRAP. ●Improved skills in OneNote have now enabled us to electronically date stamp each authorisation		

**1.6** Guidance for service managers

Though supplier employment status assessments have been carried out by the HR Admin & Payroll team since the change in legislation, in the long term the intention is for status assessments to be completed by service managers who engage suppliers before they are set up on the financial management system (SAP). Draft guidance has been produced to help facilitate this transition in responsibility. Review established that the guidance produced is comprehensive and clearly outlines the requirements for assessment and the potential implications if managers do not apply the guidance correctly.

Though the guidance was drafted in mid-2017, officers reported that there have been several amendments made to the HMRC Employment Status for Tax tool which have necessitated amendments to the guidance. This has prevented the guidance from being issued and has meant the HR Admin & Payroll team have retained the responsibility for completing assessments.

It is imperative that guidance be issued, and managers have a chance to familiarise themselves with this guidance before responsibility for assessment transfers to them. Without sufficient guidance, there is an increased risk that assessments will not be completed correctly, and this could result in penalties from HMRC.

1.6a Proposed Outcome: Priority 3

We recommend that the Strategic Manager - HR Admin & Payroll Services ensures that guidance is finalised and issued to all service and strategic managers before they become responsible for completing employment status assessments.

**Action Plan:**

•Person Responsible:	Rachel Ellins	•Target Date:	•September 2018
•Management Response  <b>Update September 2018</b>	<ul style="list-style-type: none"> <li>•The guidance will be finalised ready for launch at the Autumn Term schools ADL meetings. It will also be shared with the SCC Business Managers Group, for further circulation, at a similar time.</li> <li>•The detailed guidance and process documentation will be released at the October School Admin, Development and Liaison meetings and will also be available via the SCC intranet. Since March 2017 many employees involved in the procurement of services or processing the invoices have been trained, mainly on a one to one basis, so that they now understand the regulations and the requirements placed on the Council.</li> </ul>		

•1.7 Ongoing identification of third parties requiring assessment

During this review we met with representatives from the HR Admin & Payroll, Commercial & Procurement and Exchequer teams to establish the process by which third parties are highlighted to HR Admin & Payroll for assessment.

We observed that there are several ways that HR Admin & Payroll may be notified of third parties requiring a tax status assessment, including Commercial & Procurement approval of suppliers before they can be set up on SAP, a joint Payroll/Exchequer tax status enquiries email inbox and SAP Workcycle. We were also informed that the HR Admin & Payroll team had provided guidance to these teams on the legislative requirements and discussed potential procedural changes to ensure a tax status assessment is completed before a third party can be set up as a vendor on the financial management system (SAP). However, we were informed by representatives of Exchequer that their responsibilities within the identification process had not yet been formally defined and though they had received a draft process map this required refinement.

The responsibility for compliance with off payroll working rules does not lie with one service area and the council's success in ensuring compliance will be dependent on cross-service procedures operating effectively. If relevant parties are not aware of their responsibilities or these have not been defined, there is a risk that suppliers who are affected by these requirements will not be assessed and in turn this leads to SCC becoming liable for tax and national insurance deductions, as well as potential penalties.

1.7a Proposed Outcome: Priority 4

•We recommend that the Strategic Manager - HR Admin & Payroll Services contacts relevant officers within the Commercial & Procurement and Exchequer teams to establish agreed and documented processes for referring new suppliers for assessment.

•Action Plan:

•Person Responsible:	•Rachel Ellins	• Target Date:	•June 2018
•Management Response:	•A meeting will be arranged to discuss this proposed outcome. However excellent working relationships between the teams, shared knowledge of the requirements and the many communications, discussions and		

<b>Update September 2018</b>	sharing of the requirements with Council employees involved in the procurement process, across service areas, means that management do not believe this to be a priority risk in practice. • All teams continue to work closely together. A new vendor set up form has been developed and will soon be launched. This includes brief guidance on the Off-Payroll requirements. This should further reduce the number of requests for new vendors who should first be assessed under the regulations.
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### **3.0 Next Steps**

3.1 Further data cleanse of vendors

3.2 Issue of guidance

3.3 HR Admin and Payroll will welcome a further audit to confirm that actions have been taken that will raise the audit opinion.