



Payroll Key Controls and IR35 2017-18


Final Report




Issue Date: 17th May 2018

Working in Partnership to Deliver Audit Excellence




Executive Summary

-  This section provides an overview for senior management to understand the main conclusions of this audit review, including the opinion, significant findings and a summary of the corporate risk exposure.

Findings and Outcomes

-  This section contains the more detailed findings identified during this review for consideration by service managers. It details individual findings together with the potential risk exposure and an action plan for addressing the risk.

Appendices:

-  Audit Framework Definitions
-  Support and Distribution
-  Statement of Responsibility

Executive Summary

Overview

As part of the 2017/18 audit plan a review has been undertaken to assess the adequacy of the key controls and procedures in place for Payroll at Somerset County Council. A separate review was undertaken to review the procedures in place for the administration of IR35 legislation within the Council and our findings from both reviews are reported within this single report.

As these are distinct areas, we have offered separate audit assurance opinions.

IR35 (off payroll working rules):

IR35 legislation came into force in the year 2000 with the intention that in respect of personal taxation and national insurance (NI), individuals working through their own limited company, often as contractors in both the Private and Public-Sector Body (PSB) were treated in the same way as people directly employed, where the relationship was proved to be the same as an employee.

From 6th April 2017 it has been the responsibility of the PSB to determine whether such an individual who is not directly employed, is subject to IR35 legislation. Where it is identified that IR35 legislation applies to an individual, the PSB is required to deduct PAYE and NI from payments made for services provided.

This review sought to verify whether the Council has completed IR35 assessments for both existing and potentially new workers employed through intermediary bodies and how it is managed in the future.

Payroll Key Controls:

Since the previous audit in 2015/16, Somerset County Council agreed a formal exit programme from their partnership with Southwest One, who previously provided HR and Payroll Administration services. As part of the exit, a number of officers returned to the Council on 1st December 2016, and although the payroll procedures and system have remained the same, these functions are now carried out by the Council.

As at the beginning of the audit, the Council (including Somerset Waste Partnership) had 3,946 posts on record. This includes a mix of full time, part time and casual posts. Between August 2016 and August 2017, the Council filled 871 posts with new starters. Over the same period 2,132 Council employees left their posts, however 1,134 of these employees were transferred from the in-house Learning Disabilities service to the new provision known as Dimensions.

Due to concerns raised in another audit we also agreed to undertake a review of the process for honorarium higher grade payments and their authorisation.

Objective

To provide assurance that key controls within Payroll are operating effectively and procedures are in place to ensure compliance with IR35 legislation.

Significant Findings	
Finding:	Risk:
We were advised during this review that there was no significant review of the council's contract register or financial management system to identify suppliers potentially affected by the IR35 legislation.	Without a review of all existing suppliers, there is a risk that all intermediary bodies have not been identified and this could lead to SCC becoming liable for relevant income tax and NIC charges.
Though we observed that there are processes in place to identify suppliers to HR Admin & Payroll Services for assessments, processes and responsibilities have not yet been formally agreed and documented.	Procedures are not defined so may not be applied consistently. If staff change roles, there is no documentation available to support handover.

IR35 Audit Opinion:	Partial
<p>We can offer partial assurance. In relation to the areas reviewed and the controls found to be in place, some key risks are not well managed, and systems require the introduction or improvement of internal controls to ensure the achievement of objectives.</p> <p>The recent changes to the off payroll working rules has presented a significant challenge to PSBs, including Somerset County Council, and controls relating to this are still being developed. Through testing and discussion with officers we have confirmed that the Council took proactive steps to identify potentially affected suppliers by contacting all service and strategic managers, and school leaders. Our testing of payments made to suppliers who have been assessed and deemed to be within the IR35 legislation also identified that tax and National Insurance deductions had been calculated correctly; while walkthrough testing established that tax status assessments conducted by the HR Admin and Payroll service were reasonable based upon information available to the service.</p> <p>The responsibility for compliance with the IR35 legislation does not sit solely with HR Admin & Payroll but is shared across the organisation. We have identified two significant weaknesses relating to this which has reduced the assurance level offered. Firstly, the council has not completed a thorough review of either its vendor list or contracts register to identify existing suppliers who may be affected by the new requirements, meaning some suppliers who need to be subject to tax and National Insurance deductions may not have been identified and attempts to make payments to such suppliers will not be prevented in all circumstances. Secondly, cross-service arrangements for ensuring new suppliers are assessed on an ongoing basis have not yet been formally agreed, documented and implemented, which increases the risk that suppliers will be missed. These findings have already been communicated to the Payroll and Exchequer teams who are considering options to reduce relevant risks.</p>	

Payroll Key Controls Audit Opinion:	Reasonable
<p>We can offer reasonable assurance as most of the areas reviewed were found to be adequately controlled. Generally, risks are well managed, but some systems require the introduction or improvement of internal controls to ensure the achievement of objectives.</p>	

Testing of the key controls for starters, leavers and changes identified a reasonable level of compliance with the agreed procedures. A minor weakness was identified in relation to the authorisation list and Payroll procedures, which require updating.

More significantly we identified that even though the Honorarium Policy was suspended on 31st March 2013, there are currently 44 active payments with an honorarium wage type in place. Six of these do not have end dates and three payments have been running for over two years with no periodic reviews or central monitoring in place.

Well Controlled Areas of the Service

- The agreed action from our previous key control payroll audit regarding confirmation of payments to HMRC was found to be complete.
- There are appropriate security and authorisation arrangements in place for the BACS Payroll Submission.
- Tax status assessments completed by the HR Admin & Payroll service are based on sound rationale.
- Payments to suppliers identified as being within the IR35 legislation included accurate tax and National Insurance deductions.

Corporate Risk Assessment

Risks	Inherent Risk Assessment	Auditor's Assessment
1. The Council is liable for additional tax and NI deductions, penalties and interest due to non-compliance with IR35 regulations.	High	Medium
2. Employees are not paid or are paid incorrectly.	High	Low

Findings and Outcomes

Method and Scope

This audit has been undertaken using an agreed risk-based approach. This means that:

- the objectives and risks are discussed and agreed with management at the outset of the audit;
- the controls established to manage risks are discussed with key staff and relevant documentation reviewed;
- these controls are evaluated to assess whether they are proportionate to the risks and evidence sought to confirm controls are operating effectively;
- at the end of the audit, findings are discussed at a close-out meeting with the main contact and suggestions for improvement are agreed.

The scope of the Payroll audit covered the processes and procedures in place for transactions between August 2016 and August 2017. A sample of starters, leavers and changes were reviewed to ensure they had been correctly processed and authorised. A sample of exception reports and BACS authorisations were reviewed for compliance with the documented procedures.

For IR35 testing we obtained a report of all payments made to IR35 suppliers between April and October 2017. This showed a total of 13 payments had been made, so a sample of five payments were tested against the invoice, income tax and National Insurance thresholds to confirm that tax deductions were correct. For walkthrough testing a sample of 15 suppliers who had been subject to tax status assessment was selected and were reviewed in conjunction with the assessing officer to establish the result was reasonable in each instance.

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:

Person Responsible:	Service Manager – Chief Accountant	Target Date:	In progress
Management Response:	<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 payment since April 17 were reviewed when they were re-engaged or invoices were processed.</p>		

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:

Person Responsible:	Strategic Manager – HR Admin & Payroll Services	Target Date:	Complete
Management Response:	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.		

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:	Strategic Manager – HR Admin & Payroll Services	Target Date:	Complete
Management Response:	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.		

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.

Action Plan:

Person Responsible:	Strategic Manager – HR Admin & Payroll Services	Target Date:	In progress
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Management Response:	Additional resource has already been introduced to support the process and an additional colleague will also be trained soon.
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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:	Strategic Manager – HR Admin & Payroll Services	Target Date:	Complete
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Management Response:	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.
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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:	Strategic Manager – HR Admin & Payroll Services	Target Date:	September 2018
Management Response:	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.		

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
<p>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.</p>			
Action Plan:			
Person Responsible:	Strategic Manager – HR Admin & Payroll Services	Target Date:	June 2018
Management Response:	<p>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 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.</p>		

2. Payroll Key Controls: Employees are not paid, or are paid incorrectly.

2.1 Authorisation list

We checked a sample to ensure that each new starter and contract change had been authorised in line with the authorisation list. Whilst each form had been authorised, ten instances were identified where the authorisation list requires updating. It was also identified that two starter forms had been authorised by Team Managers who were not authorised to make permanent changes. If the authorisation list is not kept up to date, there is an increased risk that permanent and temporary changes may be inappropriate or incorrect.

2.1a Proposed Outcome:

Priority 3

We recommend that the Strategic Manager - Admin & Payroll Services ensures that the authorisation list is regularly reviewed and kept up to date.

Action Plan:

Person Responsible:	Strategic Manager – HR Admin & Payroll Services	Target Date:	July 2018
Management Response:	All schools have been contacted to update their information and we are now chasing those that have not yet responded. The SCC Business Managers are supporting us with the Council signatories and we are working towards a fully updated list during July.		

2.2 Honorarium and higher-grade payments

The HR Honorarium Policy previously in place was suspended on the 31st March 2013. However, a report run by the HR and OM Team in December 2017 showed 44 active payments in place across different service areas with an honoraria wage type, all with a start date after 2013. 42 of the payments relate to higher grade work, one to project work and one is marked 'other.' The reasons these payments are in place is not recorded on the report and have not been investigated as part of this review.

Payments with an honoraria wage type can be requested through a Personnel Change Request (PCR) on SAP. As of April 2018, only two types of honoraria can be processed this way, and the HR Admin and Payroll team implement requests if the requester is the applicable manager within the SAP organisation structure.

A separate Salary Policy (2014) exists and refers to payments for Acting Up in a Higher Graded Post. It states that a payment may be offered when an individual has undertaken 25 per cent of the duties of the higher graded post for at least four weeks, however there is no guidance on how the payments should be authorised or monitored.

Of the payments currently in place, we found six did not have end dates, and three of these payments had been in place for over two years. We have been informed that it is possible to process a request without a specified end date by entering 31/12/9999 onto the PCR. The HR Advisory team were not aware of these payments and they were not being monitored.

If additional payments are processed without end dates and authorisation requirements are not defined, there is a risk that payments may be set up inappropriately and a further risk that the member of staff will continue to receive payments even when they are no longer justified.

2.2a	Proposed Outcome:		Priority 3
<p>We recommend that the Director of HR and OD ensures that the Salary Policy includes guidance on authorisation requirements for honorarium payments and communicates this to service managers and the HR Admin & Payroll team. The payments identified should be investigated to establish why they are in place, how the level of payment has been calculated and when the payments are expected to cease, where this is not already clear. Payments without a specified end date should not be processed. Checks should be performed on a regular basis to confirm that all additional payment arrangements have recorded end dates.</p>			
Action Plan:			
Person Responsible:	Strategic Manager – HR Admin & Payroll Services	Target Date:	June 2018
Management Response:	<p>This proposed outcome will be discussed with the policy team so that a review of the guidance can be considered and current reports will be run and where necessary, managers asked to provide further information to support the payment. The narrative on the PCR MSS screen will be amended to remind managers to include an end date when setting up honoraria.</p>		

Audit Framework and Definitions

Assurance Definitions

None	The areas reviewed were found to be inadequately controlled. Risks are not well managed, and systems require the introduction or improvement of internal controls to ensure the achievement of objectives.
Partial	In relation to the areas reviewed and the controls found to be in place, some key risks are not well managed, and systems require the introduction or improvement of internal controls to ensure the achievement of objectives.
Reasonable	Most of the areas reviewed were found to be adequately controlled. Generally, risks are well managed, but some systems require the introduction or improvement of internal controls to ensure the achievement of objectives.
Substantial	The areas reviewed were found to be adequately controlled. Internal controls are in place and operating effectively and risks against the achievement of objectives are well managed.

Definition of Corporate Risks

Risk	Reporting Implications
High	Issues that we consider need to be brought to the attention of both senior management and the Audit Committee.
Medium	Issues which should be addressed by management in their areas of responsibility.
Low	Issues of a minor nature or best practice where some improvement can be made.

Categorisation of Recommendations

When making recommendations to Management it is important that they know how important the recommendation is to their service. There should be a clear distinction between how we evaluate the risks identified for the service but scored at a corporate level and the priority assigned to the recommendation. No timeframes have been applied to each Priority as implementation will depend on several factors, however, the definitions imply the importance.

Priority 5	Findings that are fundamental to the integrity of the unit's business processes and require the immediate attention of management.
Priority 4	Important findings that need to be resolved by management.
Priority 3	The accuracy of records is at risk and requires attention.

Priority 2 and 1 Actions will normally be reported verbally to the Service Manager.

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Support

We would like to record our thanks to the following individuals who supported and helped us in the delivery of this audit review:

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Distribution List

This report has been distributed to the following individuals:

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Statement of Responsibility

Conformance with Professional Standards

SWAP work is completed to comply with the International Professional Practices Framework of the Institute of Internal Auditors, further guided by interpretation provided by the Public Sector Internal Auditing Standards.

SWAP Responsibility

Please note that this report has been prepared and distributed in accordance with the agreed Audit Charter and procedures. The report has been prepared for the sole use of the Partnership. No responsibility is assumed by us to any other person or organisation.