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FINAL INTERNAL AUDIT REPORT
CHIEF EXECUTIVE'S DEPARTMENT

REVIEW OF PAYROLL (TAX)

Issued to: Director of HR & Customer Services
Head of HR Business, Systems & Reward
Assistant Director, Exchequer Services
Revenues & Benefit Manager
Director of Finance (Final report only)

Prepared by: Trainee Auditor

Reviewed by: Head of Audit and Assurance

Date of Issue: 08 June 2022

Report No.: CEX/05/2021

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INTRODUCTION

1. This report sets out the results of our audit of Payroll (Tax). The audit was carried out as part of the work specified in the 2021-22 Internal Audit Plan agreed by the Section 151 Officer and Audit Sub-Committee. The controls we expect to see in place are designed to minimise the Council's exposure to a range of risks. Weaknesses in controls that have been highlighted will increase the associated risks and should therefore be addressed by management.
2. The Council is party to a service level agreement with the Council's payroll contractor where the Council's payroll contractor processes the payments and changes to payroll on behalf of the Authority.
3. The objective of this audit was to review the adequacy and effectiveness of controls surrounding the recording and processing of tax (PAYE, NI, P11D only) through payroll.
4. We would like to thank all staff contacted during this review for their help and co-operation.

AUDIT SCOPE

5. The original scope of the audit was outlined in the Terms of Reference and subsequently we tested the following key risks:
 - Income tax (PAYE) and National Insurance (NI) may not be deducted correctly.
 - Taxes filed for employee benefits in kind (P11D) may not be correctly accounted for.
 - Payments to HMRC may not be made accurately or in a timely manner, which may result in fines or censures by HMRC.
 - Accurate records detailing all deductions made in respect of PAYE, NI and P11D may not be maintained and provided to the relevant parties such as HMRC and the employee.
6. The audit covered the period between 1 April 2021 and 31 December 2021 and the year-end processes for the financial year 2020/21.

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AUDIT OPINION

7. Our overall audit opinion, number and rating of recommendations are as follows.

AUDIT OPINION	
Reasonable Assurance	(Definitions of the audit assurance level and recommendation ratings can be found in Appendix B)

Number of recommendations by risk rating		
Priority 1	Priority 2	Priority 3
0	4	1

SUMMARY OF FINDINGS

8. The audit has identified areas of good practice and sound controls as set out below:

- Procedure notes are documented and available to staff.
- The FPS (Full payment summary) and EPS (Employer payment summary) is submitted to HMRC monthly.
- For the new employees sampled, a P45 or a new starter form was retained and tax codes applied correctly.
- For the leavers sampled, a P45 was produced and sent to those employees and HMRC was notified through the FPS submission timely.

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- Standard exception reports are produced for subsequent investigation & approval to identify any fraud and errors in calculating PAYE and NI deductions.
- Records detailing the deductions made in respect of P11D are maintained and provided to HMRC and the employee timely.
- For the employees sampled, tax code changes were applied correctly and PAYE and NI was calculated accurately.
- Deductions are paid to HMRC promptly and in full and the reconciliation of the payroll holding account is carried out monthly.

9. Management should consider the findings summarised as follows:

- Monthly payments taken for the selected samples under the Salary sacrifice scheme were correct, however, 3/15 payments had not been set up in time. This was due to human error and lack of processes in place to identify such errors.
- The Council's payroll contractor sends the monthly reports, summarising the CHAPS payments due to HMRC and Authorisation Form to run payroll to the Council's Revenues and Benefits Manager for authorisation. However, the Revenues and Benefits Manager does not have access to the payroll portal and signs off these payments without interrogating the information from an independent source.
- The NI uplift for the financial year 2022/23 was not tested before implementing on the payroll system.
- Exception reports are not run for subsequent investigation & approval to identify any fraud and errors in calculating benefits in kind deductions.
- The Council's payroll contractor shares the login provided to one team member to access the HMRC gateway. The Council's payroll contractor's Payroll Control Analyst informed us that the Council's payroll contractor is only able to have one access.

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APPENDIX A

DETAILED FINDINGS AND ACTION PLAN

1. <u>Payments under the Salary sacrifice scheme not set up timely</u>	
<u>Finding</u>	
<p>Our sample testing highlighted that although salary deductions had been made for the correct amount, three in our sample (one from the Home Technology scheme and two from the Gym Membership scheme) had not been set up in a timely manner.</p> <p>We identified that this was due to human error and lack of processes in place to identify such errors.</p> <p>The Council's payroll contractor has informed us that they have a procedure in place since March 2022, where they run a Cognos report and compare it with the records of employees receiving benefits in kind sent to them by the Council, to ensure that such payments are set up correctly and timely on the payroll system.</p> <p>However as it has been implemented very recently, we are unable to provide assurance on the adequacy and effectiveness of this process.</p>	
<u>Risk</u>	
<p>Taxes filed for employees for benefits in kind (P11D) may not be correctly accounted for in the existing financial year.</p> <p>Failure to set up the payment on time may result in financial loss to the Council or financial difficulty and inconvenience to the employee.</p>	
<u>Recommendation</u>	<u>Rating</u>
The Head of HR Business, Systems & Reward should further explore with the Council's payroll contractor and check if their verification process is sufficient and working.	Priority 2
<u>Management Response and Accountable Manager</u>	<u>Agreed timescale</u>
This will be added as a standing item to our monthly meetings with payroll to monitor.	June 2022

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<p>The project to implement a new HR/Payroll system has started and as part of this system build we will look at how this process can be automated and clearer reporting.</p>	<p>April 2023</p>
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<p><u>2. Payment due to HMRC & Payroll authorisation</u></p>	
<p><u>Finding</u></p> <p>The Council's payroll contractor sends monthly reports summarising the CHAPS payments due to HMRC and an Authorisation Form to run payroll to the Council's Revenues and Benefits Manager for authorisation. However, the Revenues and Benefits Manager does not have access to the payroll system and signs off these payments without interrogating the information from an independent source.</p> <p><u>Risk</u></p> <p>Authorising the payment without verifying it independently may result in an incorrect payment being made to HMRC or an employee by error or fraud, which may result into fines and censures by HMRC and damage to the Council's reputation.</p>	
<p><u>Recommendation</u></p> <p>The Council's Revenues and Benefits Manager should investigate with the Head of HR Business, Systems & Reward to identify a process for checking independently if reports sent by the Council's payroll contractor are accurate before authorising them, such as whether systems reports can be generated in addition to the manual spreadsheet.</p>	<p><u>Rating</u></p> <p style="text-align: center;">Priority 2</p>
<p><u>Management Response and Accountable Manager</u></p> <p>Investigation already taken place. The Council's payroll contractor is able to provide a system report that can be generated to allow for independent verification to be undertaken.</p>	<p><u>Agreed timescale</u></p> <p>Already implemented</p>

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<p>Revenues and Benefits Manager will be provided with a system report in addition to the documentation already provided to support the HMRC Chaps request.</p>	
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3. The NI uplift for the financial year 2022/23 not tested

<p><u>Finding</u></p> <p>The Council’s payroll contractor did not test the NI uplift for the financial year 2022/23 before implementing on the payroll system. The Council’s payroll contractor informed us that they could not test it as they did not get the clone of the live database completed in time for testing, but they calculated the payroll and checked the reports before the first pay period of the financial year 2022/23.</p> <p><u>Risk</u></p> <p>Implementing the software patch for the uplift in NI without testing may result in incorrect NI being deducted from employees’ salaries and may require additional time for the correct patch to be uploaded and tested.</p>	
<p><u>Recommendation</u></p> <p>The Head of HR Business, Systems & Reward should discuss and agree the approach to testing with the Council’s payroll contractor and if a workaround is required for any exceptions.</p>	<p><u>Rating</u></p> <p style="text-align: center;">Priority 2</p>
<p><u>Management Response and Accountable Manager</u></p> <p>Before each upgrade to our live system, User Acceptance Testing is undertaken in the test environment. Unfortunately, on this occasion full testing was unable to be carried out due to part of the process not being completed. Process for upgrade process to be agreed with actions and timescales for all future upgrades.</p>	<p><u>Agreed timescale</u></p> <p>End of June 2022</p>

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<p>4. <u>Login to access the HMRC gateway</u></p>	
<p><u>Finding</u></p> <p>The Council's payroll contractor staff share the login of one team member to access the HMRC gateway. The Council's payroll contractor's Payroll Control Analyst informed us that the Council's payroll contractor is only able to have one account to access the HMRC gateway.</p>	
<p><u>Risk</u></p> <p>Shared logins increase the risk of unauthorised access and loss/ misuse of associated data as transparency and accountability are reduced.</p>	
<p><u>Recommendation</u></p> <p>The Head of HR Business, Systems & Reward should investigate the situation with HMRC and then decide, in liaison with the Head of Information Management, how this should best be addressed to mitigate risks of data loss as well as staff resilience and contingency.</p>	<p><u>Rating</u></p> <p>Priority 2</p>
<p><u>Management Response and Accountable Manager</u></p> <p>This will be discussed and raised with the Council's payroll contractor and HMRC to identify a way forward.</p>	<p><u>Agreed timescale</u></p> <p>August 2022</p>

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5. <u>Exception reports for benefits in kind</u>	
<p><u>Finding</u></p> <p>The Council's payroll contractor does not run exception reports for the employees set up for benefits in kind.</p> <p>Standard exception reports are important in identifying and investigating any fraud and errors in calculating deductions.</p> <p><u>Risk</u></p> <p>Payments set up incorrectly may not be identified in time or may remain unidentified resulting in over or underpayments.</p>	
<p><u>Recommendation</u></p> <p>The Head of HR Business, Systems & Reward should interrogate the payroll system with the Council's payroll contractor and agree on the monthly exception reports that can be run for subsequent investigation & approval to identify any fraud and errors in calculating P11D deductions. Examples of such reports can be - report to check if the payments are set up correctly and timely, report to check if the employees' salary has not reached below the national minimum wage due to benefits in kind payments etc.</p>	<p><u>Rating</u></p> <div style="border: 1px solid black; background-color: #90EE90; padding: 5px; display: inline-block; margin: 10px auto;">Priority 3</div>
<p><u>Management Response and Accountable Manager</u></p> <p>Before any benefits are approved, checks are carried out already by HR regarding National Minimum Wage. If benefits were to bring someone below this level these would not be agreed. Discussions with payroll to take place with regards to additional checking on benefit deductions.</p>	<p><u>Agreed timescale</u></p> <p>July 2022</p>

Assurance Level

Assurance Level	Definition
Substantial Assurance	There is a sound system of control in place to achieve the service or system objectives. Risks are being managed effectively and any issues identified are minor in nature.
Reasonable Assurance	There is generally a sound system of control in place but there are weaknesses which put some of the service or system objectives at risk. Management attention is required.
Limited Assurance	There are significant control weaknesses which put the service or system objectives at risk. If unresolved these may result in error, abuse, loss or reputational damage and therefore require urgent management attention.
No Assurance	There are major weaknesses in the control environment. The service or system is exposed to the risk of significant error, abuse, loss or reputational damage. Immediate action must be taken by management to resolve the issues identified.

Recommendation ratings

Risk rating	Definition
Priority 1	A high priority finding which indicates a fundamental weakness or failure in control which could lead to service or system objectives not being achieved. The Council is exposed to significant risk and management should address the recommendation urgently.
Priority 2	A medium priority finding which indicates a weakness in control that could lead to service or system objectives not being achieved. Timely management action is required to address the recommendation and mitigate the risk.
Priority 3	A low priority finding which has identified that the efficiency or effectiveness of the control environment could be improved. Management action is suggested to enhance existing controls.