

# Nottingham City Homes VAT 2006-2007.

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<b>Issued to:</b>	Julie Hadfield	Head of Finance - NCH
	Jeff Abbott	Chief Accountant - NCC
<b>Copied to:</b>	Tina Adams	Taxation Advisor

<b>Contact Details:</b>		
Head of Risk & Audit Services.		
	Shail Shah	54050
Audit Manager.	Mick Ahern	54853
Auditor.	Steve Hales	54180



# 1 Executive Summary

- 1.1 At the request of NCH City Audit Services have reviewed the systems and controls in place to establish whether there is reasonable assurance that the liability for VAT in relation to Nottingham City Homes (NCH) is correct. This review has mainly concentrated on Income (output VAT) but has also looked at the coding of expenditure invoices to ensure these are being accounted for correctly.
- 1.2 Since the VAT liability is calculated from the City Council's ledgers centrally it is imperative that these ledgers reconcile with NCH's systems (i.e. ROCC and SX3). Therefore we have looked at the controls within NCH to ensure that this is the case and our overall finding is that these controls are now operating effectively.
- 1.3 However, during the audit we were informed that part way through the year it was discovered that VAT on some of NCH's income was not being accounted for correctly and a voluntary disclosure of £348,663.15 has been made to the HM Revenue and Customs in respect of this. This discovery was as a result of the additional control measures introduced by NCH.
- 1.4 Whilst action has now been taken to ensure that VAT is accounted for correctly on this income, in that NCH staff post manual entries for the VAT element on this income and they have introduced a monthly income reconciliation process, we found that this disclosure was calculated incorrectly and had been overstated by £4,243.53. This was down to an error on the spreadsheet used by NCH to calculate the outstanding VAT due to HMRC. We have advised the appropriate staff within the City Council and NCH and they are to liaise to correct this and ensure that HMRC are advised accordingly.
- 1.5 As stated above the control measures introduced by NCH have added to the assurance that income in particular is complete and accurate. This has addressed the major concern as there is a manual aspect to the posting of some NCH income, and associated VAT, to the OneWorld system, whereas expenditure is processed directly in this system.
- 1.6 In addition copies of the VAT returns are now being provided to NCH and NCH staff have liaised with the City's Taxation Advisor to verify the VAT liability. If this liaison continues this will enable separate verification of the VAT liability by NCH and contribute further to the assurance that the VAT liability is correct.
- 1.7 Other minor findings of the work were:
  - There is currently a lack of separation of duties within the City Council as the Taxation Advisor is currently responsible for all aspects of the quarterly VAT process. This is to be addressed in the future through the appointment and training of a Taxation Assistant.
  - As part of the quarterly VAT process reliance is placed on the accuracy of the City Council's tax files and ledgers. No checks are

made to ensure staff are accounting for VAT correctly at NCH and no checks are made to NCH source systems. However, we confirmed with NCH staff that checks do take place at the point of input. In addition the Taxation Advisor stated that it is proposed that a series of mini audits within Departments (including NCH) is carried out.

- Training sessions are held corporately covering VAT issues, however, these are currently aimed specifically at the treatment of VAT from a City Council aspect.
- 1.8 Also during the audit issues were raised regarding a potential breach of VAT regulations in that NCH were possibly failing to invoice for work carried out within 14 days of completion. This has an effect on the tax point for VAT. Hence VAT may not be accounted for in the correct period. Both NCH and NCC are aware of this and it is recommended that NCH provide details to the Taxation Advisor of the potential value of this work and the reasons why the invoice cannot be raised within the 14 day period so that this can be assessed and if necessary the Taxation Advisor can then contact HMRC who may allow a concession.
- 1.9 It should also be noted that previous audit work on repairs has highlighted concern over the accuracy of the invoicing process at NCH and has recommended corrective action. This means that whilst the VAT on these invoices has been calculated correctly there is a question over the accuracy of the amount of the initial invoice. However detailed responses have been given to these recommendations and the action planned if implemented, should ensure that income is correct. This will be followed up as part of the follow up work for that particular audit.

## **2 Introduction**

- 2.1 Nottingham City Homes (NCH) is an arms length organisation that came into being on 1 April 2005. It is a non-profit making organisation run by a Board of non-executive directors made up of councillors, tenants, leaseholders and independent members.
- 2.2 As such NCH is a separate VAT registered entity. However, VAT is accounted for through the City Council's systems and is reconciled centrally by the City Council. The City Council also submits VAT returns to HM Revenue and Customs (HMRC) on behalf of NCH under the terms of an SLA.

## **3 Scope and Approach**

- 3.1 This audit review has been primarily to establish whether there is reasonable assurance that the liability for VAT in relation to NCH is correct and to review the processes for establishing this liability.
- 3.2 It has concentrated on the controls in place to ensure that, in respect of VAT, invoices have been treated correctly by NCH and NCC and

whether there is adequate assurance that the information in the City Councils OneWorld system, which forms the basis of the quarterly reconciliation to establish the VAT liability, is correct. Work has primarily concentrated on the income side.

- 3.3 Much of this assurance is gained from the controls in place, since Autumn 2006, to ensure that the two systems used by NCH and the City Council (ROCC and Oneworld) reconcile.
- 3.4 We have, therefore, established the existence of such controls and have also carried out detailed testing of a number of individual invoices to establish the accuracy of the coding of VAT.
- 3.5 In addition, since the returns are processed centrally, we have looked at the process for formulating and submitting the returns to ensure that there is an adequate audit trail and the returns are correct.

Therefore the audit review has been split into two parts:

- Review of controls centrally (Nottingham City Council) – to establish that adequate controls are in place to ensure that the correct amounts are paid over to HMRC in respect of VAT for NCH. This work has looked in particular at the quarterly reconciliation process.
  - Review of the systems in place at NCH to ensure controls are adequate to ensure that VAT is accounted for correctly and fully and that information provided to the City Council is adequate, to ensure that amounts paid over to HMRC are correct in respect of VAT due.
- 3.6 To establish the above meetings were held with relevant staff from both the City Council and NCH to establish details of the systems in place and the existence of key controls.
  - 3.7 In addition testing was carried out centrally, looking at a sample of VAT returns. A random sample of invoices (sales and purchase) was also reviewed in detail at NCH to establish that VAT had been dealt with correctly.
  - 3.8 Details of the findings in each area are shown below in the summary of findings. In addition where there are recommendations these are shown in the action plan (split by those to be addressed by the City Council and those by NCH) and should be addressed by the relevant Service Manager.
  - 3.9 It is the responsibility of management to determine the action that will be taken in response to each recommendation, after carrying out an assessment of the risks involved and the cost-effectiveness of the control improvements recommended.
  - 3.10 Management should note that any recommendations that relate to Financial Regulations must be implemented unless a satisfactory business case can be prepared, justifying why the recommendation will not be implemented. The implementation of these will be followed-up after the issue of a Final Report.
  - 3.11 Also, included in the report is a glossary of the terms.

## 4 Summary of Findings

4.1 As detailed above NCH is a separate VAT registered entity. However, VAT is accounted for through the City Council's systems and is reconciled centrally by the City Council. The City Council also submits VAT returns to HMRC on behalf of NCH. Therefore the audit review was split to look at the systems and controls both within Nottingham City Council and NCH and the findings are shown below under these headings.

### 4.2 Central – Nottingham City Council

4.2.1 It was established that the City Council accounts for its VAT on a monthly basis. However, VAT for NCH is accounted for on a quarterly basis with a reconciliation being performed quarterly to establish the amount payable to HMRC on behalf of NCH.

4.2.2 During each quarter two monthly payments are made on account with the remaining payment being made, following completion of the reconciliation, in the month following the end of the quarter along with a submission of the VAT return for that quarter. This is done electronically.

4.2.3 As part of the reconciliation process the City Council's Taxation Advisor extracts information from the ledger and control accounts. These two reports are then reconciled, by use of a spreadsheet, to identify any discrepancies. These reports were reviewed and the transfer of information to the spreadsheet was checked. In addition the spreadsheet calculations were verified.

4.2.4 As part of the audit review a slight discrepancy was identified. It was established that this was in respect of a posting that had been made in error. This has been subsequently corrected.

4.2.5 This process places significant reliance on the completeness and accuracy of the information in these reports (i.e. that all VAT has been accounted for correctly in OneWorld).

4.2.6 Initially, in respect of income that NCH receives from the City Council's Design and Property Services, income was being paid to NCH gross. However, no action was being taken to allocate the VAT element to NCH's output VAT account.

4.2.7 As stated previously in the report, NCH introduced control measures that highlighted this error and action has been taken to correct this. NCH staff now, as part of an overall income reconciliation process, manually post the VAT element relating to this income. This ensures that the output VAT appears in the OneWorld system and is therefore picked up as part of the reconciliation process carried out centrally by the City Council's Taxation Advisor.

4.2.8 In addition, since the reconciliation process places significant reliance on the information within these OneWorld reports (i.e. that all VAT has been coded correctly), there should, therefore, be controls at NCH at

the point that the invoices are processed to ensure they are entered correctly. Subsequent testing confirmed that this is the case.

4.2.9 The Taxation Advisor stated that she would be carrying out a series of mini audits of various areas (including NCH) to ensure that the correct action was being taken in respect of VAT. In addition the Taxation Advisor confirmed that training sessions are held corporately covering VAT issues, however, these are currently aimed specifically at the treatment of VAT from a City Council aspect.

4.2.10 It was also established during the audit that copies of the VAT returns were not being provided to NCH. We have now been assured that this is taking place. In addition, whilst the audit has been ongoing, staff from NCH have visited the Taxation Advisor to view past reconciliations and identify any possible discrepancies. In a recent meeting with the Taxation Advisor we were informed that only minor issues have arisen from this. If these processes continue this will provide additional assurance that the VAT return is correct as NCH will be able to independently verify the VAT liability.

4.2.11 As part of the testing the Taxation Advisor was provided with a control questionnaire. This has been subsequently returned and the responses assessed.

4.2.12 The main points arising from this were:

- There is a lack of separation of duties. The Taxation Advisor carries out the reconciliation, checks the detailed workings and completes the VAT return. A Taxation Assistant is currently being trained to take on some of these responsibilities.
- There is not a VAT file / manual kept which details the process for completing VAT returns in relation to NCH, contains copies of all VAT returns and any copies of correspondence / notes of telephone calls in respect of VAT.

### 4.3 **Nottingham City Homes (NCH)**

4.3.1 Testing at NCH was carried out in 2 areas:

- Specific testing of a selection of invoices (sales and purchase) to establish that VAT has been accounted for correctly.
- Discussions with appropriate staff to establish the controls in place to ensure that the information within the City Councils systems accurately reflects that within NCH's system.

4.3.2 This testing showed:

#### 4.3.3 **Testing on specific invoices**

4.3.4 We selected a sample of invoices relating to both NCH income and expenditure, including a selection of invoices that did not have any VAT element on them to establish that VAT had been accounted for correctly.

4.3.5 Generally the testing was satisfactory but we found the following:

- 2 debtor invoices for repair work had been incorrectly raised for NCH instead of NCC Housing. It should be noted that the

calculation of VAT was correct on these invoices. Note - The amounts involved were minimal.

- A Bodill invoice had been submitted for payment which had a VAT element:
  - Cost £8,590.83
  - VAT £1,503.40
  - Total Due £10,094.23

4.3.6 However the VAT element has not been accounted for. The procedures at NCH were found to be satisfactory and the error was due to operator input error at the City Council. This was a Construction Industry Scheme invoice and was therefore sent to the City Council's Support Services for input.

#### 4.3.7 **Reconciliation of NCH System to City Council System**

4.3.8 NCH expenditure is processed directly through the OneWorld system as there is an interface between the ROCC system and OneWorld. However, there is a manual element relating to some income being accounted for on OneWorld. Therefore this part of the testing has specifically looked at NCH income and a meeting was held to establish precise details of the types of income and the systems and controls in place to ensure that all details are reflected accurately in the City Council's OneWorld system, as this is the system used by the City Council to establish the VAT liability.

4.3.9 At NCH details of the costs on specific jobs are processed through the ROCC system. This information then enters the City Council's OneWorld system via the raising of related invoices or through occasional journal entries.

4.3.10 This part of the audit review has been primarily to establish whether there is reasonable assurance that all income, and particularly output VAT, is fully and accurately reflected in OneWorld.

4.3.11 We have split out findings into three types of income stream as shown below.

#### 4.3.12 **Income from Design and Property Services**

4.3.13 These invoices are not raised in OneWorld. NCH Corporate Property raise an invoice within ROCC and this is then sent to Nottingham City Council's Design and Property Services, who pay against the invoice raised.

4.3.14 Income is then paid through the City's bank and credited to NCH.

4.3.15 The process now is that the output VAT element relating to this income is manually processed into the OneWorld system by journal. This is a system that NCH has introduced.

4.3.16 Previously this process was not carried out and output VAT was not being accounted for in the OneWorld system and therefore a voluntary disclosure has been made to HMRC of £348,663.14 in respect of outstanding VAT due.

4.3.17 A spreadsheet was supplied that listed the invoices that made up this amount and this was analysed as part of the audit. This showed the errors as shown in the table below (information shown in columns 1 to 5 has been extracted directly from the spreadsheet)

Job No.	Invoice No.	Amount			Comments
		Net	VAT	Gross	
ZL6107	250397/A	231.26	40.47	271.73	VAT should be 40.47
ZT9530	302168/A	23.84	41.17	28.01	VAT should be 4.17
ZT9221	302081/A	179.45	31.46	211.21	VAT correct - Net amount should be 179.75
ZU1557	368704/A	111.82	219.57	131.39	VAT should be 19.57

4.3.18 The net result of these errors is that the voluntary disclosure has been overstated by £4,243.53. This has been pointed out to both NCH staff and the City Council's Taxation Advisor and they are to liaise to ensure the HMRC are advised of the correct figure and the necessary action is taken to correct the accounts.

4.3.19 As stated this error came to light as a result of control measures introduced by NCH and therefore the action now taken by NCH ensures that this income is accounted for in the correct manner within OneWorld (i.e. the VAT element is posted to NCH output VAT) and is picked up as part of the central VAT reconciliation.

#### 4.3.20 Other income processed directly in OneWorld

4.3.21 Works orders are raised through the SX3 system. This system interfaces with the ROCC system which produces invoices for the value of the work. Weekly reports are run from SX3 of all work done. An invoice is then manually raised to charge the City Council for the total value of the work done. This invoice is processed through OneWorld and therefore VAT is accounted for directly in the City's system. There is however no evidence that there has been a check that the manual invoice raised accurately reflects the SX3 reports.

4.3.22 NCH staff do, however, carry out a reconciliation between ROCC / SX3 and OneWorld that will subsequently highlight any omissions / errors. Subsequently budget lines are also monitored which may also highlight possible discrepancies.

4.3.23 We do however recommend that an independent check be made at the point of manually raising the invoice to ensure it reconciles with the SX3 report and that this is evidenced.

#### 4.3.24 Other Non SX3 (Including Schools)

4.3.25 Invoices are raised on the ROCC system and a corresponding invoice is raised on OneWorld. Therefore VAT is directly accounted for through the City Council's OneWorld system.

4.3.26 In order to ensure that all income is accounted for the following controls are in place:

- A spreadsheet is maintained that lists all the invoices raised and this is reconciled to the ROCC debtor.

- As invoices are processed through the OneWorld system these are manually logged on the spreadsheet to ensure that all income has been received.

## 5 Action Plan

Ref	Finding	Recommendation	Priority	Management Response	Responsibility and Target Date
<b>Central</b>					
5.1.1	Currently the Taxation Advisor is responsible for and carries out all aspects of the quarterly VAT process. This includes the preparation, completion, checking and submission of the return.	A Taxation Assistant is trained in all aspects of the VAT process to ensure that there are adequate contingency arrangements and separation of duties.	Medium	Currently there are insufficient resources to cover this type of work. This has been brought to the attention of management and it is hoped that in the future a Taxation Assistant will be appointed and this will be incorporated in their duties.	Taxation Advisor Oct / Nov 07
5.1.2	The Taxation Advisor places reliance on the accuracy of the OneWorld reports when calculating the VAT liability. No checks are made to ensure staff are accounting for VAT correctly at NCH and no checks are made to NCH source systems.	Periodic visits should be made to ensure that reliance can be placed on the controls in place and that VAT is being accounted for correctly at NCH at the point of input and to verify the tax liability to NCH source systems.	Medium	The Taxation Advisor is to introduce a series of mini audits once the above has been addressed.	Taxation Advisor Oct / Nov 07

5.1.3	Currently there is no VAT file maintained. The Taxation Advisor is aware that this should be introduced.	A VAT file should be maintained that contains details of all VAT returns and details of how they are prepared, copies of any correspondence / notes of telephone calls made in relation to VAT and an up to date certificate of VAT registration	Low	This has now been implemented	Implemented
5.1.4	Copies of the quarterly VAT returns are not being provided to NCH.	Copies of the quarterly VAT returns should be provided to NCH so that they may separately confirm the VAT liability.	Medium	Copies of the VAT returns are now being provided to NCH.	Taxation Advisor Implemented
5.1.5	The Taxation Advisor confirmed that training sessions are held Corporately covering VAT issues, however, these are currently aimed specifically at the treatment of VAT from a City Council aspect.	The Taxation Advisor should liaise with NCH staff to identify any possible areas for training	Medium	Agreed.	Taxation Advisor By end of 2007
5.1.6	The VAT element on a purchase invoice has not been accounted for. Therefore input VAT has been understated.  This invoice was passed to NCC Support Services for processing.	NCC staff should check at the point of input of invoices that VAT has been accounted for correctly.	Medium	Appropriate journal entries will be processed	Taxation Advisor August 2007

<b>NCH</b>					
5.1.7	We found 2 debtor invoices that whilst the calculation of VAT was correct the invoices had been incorrectly coded to NCH instead of NCC Housing – Note – the amounts involved were minimal.	Necessary action should be taken on OneWorld to rectify this miscoding.	Low	Miscoding errors have been rectified and the VAT rules in respect of the invoiced company are now well understood and procedures have been changed.	Implemented
5.1.8	An invoice is manually raised through OneWorld to charge the City Council for the total value of the certain repair works. There is no evidence that an independent check is carried out to ensure that the manual invoice raised accurately reflects the SX3 reports.	An independent check should be carried out to ensure the manual invoice reflects the SX3 report and this should be evidenced.	Low	There is a monthly income reconciliation process now in place and this will highlight any discrepancies.	Implemented
5.1.9	NCH are not being supplied with copies of the quarterly VAT returns.	It has been recommended that the City Council supply copies of the VAT returns to NCH, which we understand is now occurring. On receipt, NCH staff should verify that the VAT liability is correct and if not should liaise immediately with the Taxation Advisor to identify any problems.	Medium	Agreed	NCH Staff Immediately

Joint					
5.1.10	A voluntary disclosure has been made to HMRC as a result of NCH income being allocated gross and hence output VAT on this income not being accounted for. We have examined the calculation of this disclosure and found that it has been overstated by £4,243.53. Note – control measures have been introduced by NCH to ensure that the output VAT is accounted for in the Oneworld system correctly.	The City Council's Taxation Advisor and NCH staff should liaise to ensure HMRC are informed of the error and to ensure that the necessary action is taken to correct the accounting records.	Medium	Agreed	NCH Staff / Taxation Advisor.  August 2007.
5.1.11	During the audit issues were raised regarding a potential breach of VAT regulations in that NCH were possibly failing to invoice for work carried out within 14 days of completion. Hence VAT may not be accounted for in the correct period. Both NCH and NCC are aware of this. and it is recommended that NCH provide details to the Taxation Advisor of the potential value of this work and the reasons why the invoice cannot be raised within the 14 day period so that this can be assessed. If necessary the Taxation Advisor can then contact HMRC who may allow a concession.	NCH should provide details to the Taxation Advisor of the potential value of this work and the reasons why the invoice cannot be raised within the 14 day period so that this can be assessed. If necessary the Taxation Advisor can then contact HMRC who may allow a concession.	Medium	Agreed	NCH Staff / Taxation Advisor.  August 2007

Signed..... Date.....

**(Service Manager or above - NCH)**

Signed..... Date.....

**(Service Manager or above - NCC)**

## Glossary of Terms

### 1 Categorisation of Recommendations

The recommendations within this report have been categorised by City Audit Services as:

High Priority	A fundamental weakness which presents material risk to the audited body and requires urgent attention by management.
Medium Priority	A significant weakness whose impact or frequency presents an unacceptable risk to the audited body that should be addressed by management.
Low Priority	The audited body is not exposed to any significant risk, but the recommendation merits attention.

In all cases Internal Audit will follow up implementation of the recommendations by the agreed date.