



West Midlands Combined Authority

Internal Audit Report: IR35 2022 – 2023 Compliance Review

Report Date: 19 June 2023

Report Distribution:

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1. Executive summary

Introduction

An audit of West Midlands Combined Authority's (WMCA) IR35 management arrangements was undertaken as part of the approved internal audit plan.

On 6 April 2017 the government enforced IR35 on all public sector contracts. 'IR35' is the name given to a tax legislation that is aimed at identifying individuals who are avoiding paying tax and national insurance. The IR35 legislation specifically challenges those people who supply their services to the WMCA via their own company, often known as a 'personal service company', or a limited liability partnership, who, in the eyes of Her Majesty's Revenues & Customs (HMRC), should be classed as 'disguised employees'. Therefore, they should be taxed the same way that a general employee should be, thus falling under IR35 legislation.

Objectives, potential risks, and scope of audit work

Our audit was conducted in conformance with the Public Sector Internal Audit Standards and considered the following:

Objectives:	A review of the management of IR35 to ensure WMCA has robust systems and procedures in place to manage compliance with IR35 to avoid the risk of financial penalties.
Potential Risks:	<ul style="list-style-type: none">• Ineffective governance arrangements exist for managing the risks posed by IR35.• The organisation is exposed to financial penalties for failing to identify contractors who fall under IR35.• Failure to notify both contractors, and their intermediary, that they are liable under IR35.
Scope:	A review of the: <ul style="list-style-type: none">• policies and strategies in place for managing IR35;• systems and processes in place for identifying all contractors used by the organisation;• systems and processes in place for assessing whether identified contractors are liable under IR35;• systems and processes in place for notifying the contractor, and their intermediary, of their assessment outcome.
Limitations to the scope of our audit:	This was a high-level review of arrangements and testing was limited to the period 1 April 2022 to 31 March 2023 for the purpose of this review.

Overall conclusion

Our audit provides **Limited** assurance over the adequacy of the controls reviewed as part of the process to mitigate risks to an acceptable level.

No Assurance	Limited	Satisfactory	Substantial
Immediate action is required to address fundamental gaps, weaknesses or non-compliance identified. The system of governance, risk management and control is inadequate to effectively manage risks to the achievement of objectives in the area audited.	Significant gaps, weaknesses or non-compliance were identified. Improvement is required to the system of governance, risk management and control to effectively manage risks to the achievement of objectives in the area audited.	There is a generally sound system of governance, risk management and control in place. Some issues, non-compliance or scope for improvement were identified which may put at risk the achievement of objectives in the area audited.	A sound system of governance, risk management and control exists, with internal controls operating effectively and being consistently applied to support the achievement of objectives in the area audited.

This assurance opinion has been given due to the levels of non-compliance with WMCA IR35 processes, together with the absence of evidence that individual assessed workers were notified of their determination decision or that checks were made that the correct tax treatment to payments made were applied.(except for workers supplied via agencies). Therefore, if WMCA was subject to an independent inspection by HMRC there is a risk that they could be penalised, particularly if any workers in question were considered to be in scope and were required to put third party payroll provisions in place.

Key issues identified

We rate each issue identified based on the following:

Red Action is imperative to ensure that the objectives for the area under review are met	Amber Action is required to avoid exposure to significant risks in achieving objectives	Green Action is advised to enhance risk control or operational efficiency
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We have identified one **red** and four **amber** issues where improvements could be made, arising from the following:

- From audit testing, levels of non-compliances were identified where WMCA IR35 processes had not been followed. In several cases supporting documents were not available as evidence for this review. Further, checks of employment status had also not been completed until several months after worker start dates. Contributory factors for this were advised to be due to late notification to Payroll Services of worker start dates.
- The WMCA Agency Protocol sets out the requirements for the supply of services to WMCA. However, the protocol which was dated prior to 2017 and had not been updated to include the current working practices and the requirements since the introduction of IR35.

- Also, WMCA's process for identifying and capturing workers for assessment for IR35 had not been updated since 2017. Further, these processes did not take into account new ways of working resulting from the pandemic including remote working, which could result in workers not being captured for IR35. This is because existing processes rely on HR notifying Payroll Services to assess new workers based on new workers requiring door entry passes, equipment etc.
- No IR35 Policy is in place or updates to the Board on changes in legislation or guidance since an 'off payroll working in the Public Sector Report' was presented to the Corporate Services Board on 21 March 2017.
- A complete register / central record had not been kept up to date of IR35 employment status checks undertaken to evidence compliance with IR35 legislation.

This report will also be presented to the Audit, Risk and Assurance Committee.

Examples of good practice identified

During our work we identified the following examples of good practice in the management of risk, as achieved through the effective design and application of controls:

- Identified contractors and agency staff are assessed using HMRC's Employment Status tool by Payroll staff.
- Standard questionnaires, letter templates and a status determination document notifying hiring managers and workers of their determined statuses have been developed.
- WMCA provide an intermediary service by processing contractors through their payroll.
- The Payroll and Pensions Manager is nominated as the responsible person for managing the requirements of IR35.

Acknowledgement

Several employees gave their time and co-operation during this review. We would like to record our thanks to all the individuals concerned.

2. Findings and recommendations

Action is imperative to ensure that the objectives for the area under review are met
Red

1. Absence of checks for assessing whether identified workers are liable under IR35

Findings:

Sample testing of ten workers engaged by hiring managers and identified by Payroll Services as requiring assessing for their employment status were reviewed.

The following levels of non-compliances were identified where processes to ensure compliance with IR35 had not been followed:

Tested	Number of instances out of the ten where the area tested failed / was an exception.	Other comments	Summary
The WMCA employment status questionnaire was sent to the hiring manager in advance of the workers start date.	Five out of ten cases (50%) were an exception / failed the test.	In three out of the five cases which were an exception, questionnaires were sent two, five and six months following the workers start date. The Payroll Manager advised that these delays, with the exception of one case due to Payroll resource limitations, were due to starter notification forms being received late. However, evidence of the dates worker start date notification forms were received was not provided.	In 50% of the cases tested the WMCA employment status questionnaire was not sent to the hiring manager in advance of the workers start date. In three out of the five cases which were an exception, questionnaires were sent two, five and six months following the workers start date.
Managers completed and returned the WMCA employment status questionnaire within 30 days of it being sent to them. (30 days is not a statutory timescale but judged to be a reasonable timescale for questionnaire's to be returned to reduce the risk of workers not being assessed for their tax status prior to starting work)	Four out of ten cases (40%) were an exception / failed the test.	In a further one case the date the questionnaire was sent was not recorded on the central record.	In 40% of the cases tested, managers did not complete and return the WMCA employment status questionnaire within 30 days of it being sent to them.
Was the HMRC determination toolkit completed within 30 days of the workers start date.	Six out of seven applicable cases (85%) were an exception / failed the test of the HMRC determination toolkit being completed within 30 days of the workers start date. Toolkits were subsequently completed in all cases.	In six of the seven applicable cases, the HMRC determination toolkit was completed after four months of the workers start date and in one case after the workers engagement end date.	In 85% of the applicable cases tested, the HMRC determination toolkit was not completed within 30 days of the workers start date. Whilst there is no statutory timeframe for the completion of an SDS the guidance states the employer must take reasonable care in making a decision. The risk to the organisation in not making prompt determinations is the employer is has to deduct income tax, national insurance, and employer National Insurance

Action is imperative to ensure that the objectives for the area under review are met
Red

			contributions until worker has been informed of the decision. Therefore it is in our opinion that SDS should be completed within one month of the worker starting in order for the worker to put appropriate measures in place, if needed, or appeal the decision.
Was the outcome of the HMRC determination tool clearly stated on the central summary spreadsheet record maintained. (i.e. can the reader understand from the narration the IR35 determination outcome)	Five out of ten cases (50%) were an exception / failed the test.		In 50% of the cases tested the outcome of the HMRC determination tool was not clearly stated on the central summary spreadsheet record maintained.
Was a status determination statement and the HMRC determination toolkit evidenced as being sent to the hiring manager (or their replacement / substitute where they had left) to confirm approval / accuracy.	Four out of ten cases (40%) were an exception / failed the test.		In 40% of the cases tested, a status determination statement and the HMRC determination toolkit was not evidenced as being sent to the hiring manager (or their replacement / substitute where they had left) to confirm approval / accuracy.
Following Manager approval - was the HMRC determination toolkit outcome, status determination statement and letter sent to the worker or third party.	Four out of seven applicable cases (57%) were an exception / failed the test.		57% of the applicable cases tested, the HMRC toolkit outcome, status determination statement and letter was not evidenced as sent to the worker or third party.

Implications:

The organisation may be exposed to financial penalties if unable to evidence to HMRC that contractors who fall under IR35 have been identified.

Agreed Recommendations:

- (i) The WMCA employment status questionnaire will be sent to the hiring manager in advance of the worker's start date

Group Payroll and Pensions Manager Comment:

We will work with HR colleagues to ensure the employment status questionnaire is completed in advance of start date.

- (ii) A review of existing escalation processes will take place where managers do not complete and return the WMCA employment status questionnaire within 30 days of it being sent to them.

Group Payroll and Pensions Manager Comment:

We will work with HR colleagues to ensure the employment status questionnaire is completed and returned within 30 days. The new system when implemented will automate this action.

- (iii) The HMRC determination toolkit will be completed within 30 days of the workers start date.

Action is imperative to ensure that the objectives for the area under review are met
Red

Group Payroll and Pensions Manager Comment:

We will work with HR colleagues to ensure the employment status questionnaire is completed and returned within 30 days.

- (iv) The outcome of the HMRC determination tool will be clearly recorded on the central summary spreadsheet record maintained. Further, the spreadsheet should be brought up to date and supervisory checks should be made and evidenced on this record to ensure it is accurately completed.

Group Payroll and Pensions Manager Comment:

This data is already available within the questionnaire workflow, therefore likely the central spreadsheet will no longer be utilised as secondary to the workflow details, however the move to BW use as a database will provide additional support, likely to be implemented Q3 of 2023-24.

- (v) A status determination statement and the HMRC toolkit outcome will be sent to all hiring managers where this has not occurred to confirm approval / accuracy in all cases and retained as evidence. Where managers disagree, a review of the tax treatment of payments made should be completed and where payments have been incorrectly treated HMRC should be contacted to resolve individual cases.

Group Payroll and Pensions Manager Comment:

This is the case already however, those sent via email will now also save a copy of the email to file.

- (vi) A HMRC outcome, status determination statement and letter should be sent to the off-payroll worker and third party in all cases.

Group Payroll and Pensions Manager Comment:

This is the case already, however those sent via email, will now also save a copy of the email to file.

Responsible Officer:

Kate Ketteringham – Group Payroll and Pensions Manager

Target Date:

- (i) Where practical this action is already in place. Following implementation of Contingent Workforce Policy and comms launch – September 2023
- (ii) Where practical this action is already in place. Following implementation of Contingent worker Policy and comms launch this will be in place – September 2023
- (iii) Where practical this action is already in place. Following implementation of Contingent worker Policy and comms launch this will be in place – September 2023
- (iv) With immediate effect
- (v) With immediate effect
- (vi) With immediate effect

**Action is required to avoid exposure to significant risks in achieving objectives
Amber**

**2. Agency Protocol not updated
(Previous agreed recommendation not implemented re-iterated)**

Findings:

The WMCA Agency Protocol sets out the requirements for the supply of services to WMCA. However, the protocol which is dated prior to 2017 does not include the working practices and the requirements of IR35. This was identified in our previous review and a recommendation was made and agreed to update the protocol, which has yet to be actioned.

Implications:

There is a risk that agencies do not comply with IR35.

Agreed Recommendation:

The Human Resources Agency Protocol will be updated to include IR35 and WMCA's systems, processes and requirements relating to IR35.

Group Payroll and Pensions Manager Comment:

Contingent Worker Policy will replace and update this.

Responsible Officer:

Alex Morrow – HR Recruitment Manager
Kate Ketteringham – Group Payroll and Pensions Manager

Target Date:

September 2023.

3. Processes may not capture workers or assessment for IR35

Findings:

The process for identifying and capturing workers for the assessment of IR35 had remained unchanged from the process introduced from 6 April 2017.

However, a review and assessment identified:

- The pandemic has brought new ways of working where door entry passes are no longer required with remote working etc.
- Further, it was identified that a risk exists where a worker could bypass existing processes which are dependent on workers requiring HR input, or where Accounts Payable do not recognise a limited company is potentially an IR35 case.
- A recommendation was also previously made that a formal process should be developed for the identification and reconciliation to Payroll IR35 records of suppliers, and sub-contractors who have been set up with IR35 supplier codes on the Accounts Payable System.

However, based on information provided by the Payroll & Pensions Manager it was established that a formal process had yet to be developed for the identification and reconciliation to Payroll IR35 records of suppliers, and sub-contractors who have been set up with IR35 supplier codes on the Accounts payable system.

Implications:

The organisation may be exposed to financial penalties for failing to identify contractors who fall under IR35.

Agreed Recommendations:

A review of existing processes will be undertaken and updated to ensure they are robust to include;

- (i) Updated processes will be incorporated into a WMCA IR35 policy and disseminated to relevant employees / departments (i.e. Accounts Payable and Procurement)
- (ii) **Recommendation previously made yet to be implemented**
A formal process will be developed for the identification and reconciliation to Payroll IR35 records of suppliers, and sub-contractors who have been set up with IR35 supplier codes on the Accounts payable system.

Group Payroll and Pensions Manager Comment:

- (i) Risk is minimal of a worker bypassing existing processes and being within IR35, as no worker is allowed ICT access or building entry within being registered as a worker. The new contingent worker policy set out the responsibilities for hiring manger, procurement etc.
- (ii) A formal process is already in place, as evidenced in the provision of AP correspondence to payroll and the documentation showing AP responsibilities.

A review was actioned to see if a flag could be placed on suppliers where there is possibility of IR35 suppliers, however this was not practical, therefore the process is as per the evidence provided.

Where a worker is identified to be IR35 and paid via payroll direct a flag is set on the supplier to prevent the company being paid both by AP and Payroll.

Responsible Officer:

Kate Ketteringham – Group Payroll and Pensions Manager

Target Date: (i)

September 2023

(ii) Now implemented

4. Absence of an IR35 Policy and Board update on IR35**Findings:**

As part of our previous audit review, an 'off payroll working in the Public Sector Report' was identified as being presented to the Corporate Services Board on 21 March 2017.

However, at the time of audit testing, a review with the Payroll and Pensions Manager identified that since writing the report in 2017:

- no review or updates to the previous 'off payroll working in the Public Sector Report' had taken place for changes in guidance, legislation or work practices. i.e. from 2021, the liability for assessing IR35 status for tax purposes became no longer solely on the contractor's intermediary but the end business organisation.

- No WMCA IR35 Policy is in place / exists.
- the Board had not been provided with an update on IR35 for changes in HMRC guidance or legislation and to provide assurance of the West Midlands Combined Authority's continued compliance with IR35.

Implications:

The WMCA's IR35's procedures and strategy to ensure compliance with legislation may be outdated and result in non-compliances.

Recommendations:

- An up to date IR35 Policy and procedure will be written and presented to the Board for approval.
- An update report will be presented to the Board on the on IR35 including changes in guidance and legislation since the previous update in 2017.

Group Payroll and Pensions Manager Comment:

- Contingent Workforce Policy was approved by Corporate Management Team in May 2023 which includes a section on IR35.
- With the introduction of IR35 in April 2017 for public sector organisations this changed the liability for assessing IR35 status for tax purposes to end business (i.e. the public sector organisation) rather than being solely on the contractor's intermediary. The 2021 HMRC changes for public sector organisations were only to introduce an additional procedural change to ensure SDS's where being provided. All other element remain unchanged. Therefore this recommendation is not agreed.

Update following draft report being issued.

A Contingent Workforce Policy was evidenced, which was advised to be approved by Corporate Management Team in May 2023 which includes a section on IR35 aimed at addressing the issues raised in the audit. Work was advised to be currently underway in implementing the policy.

Responsible Officer:

Kate Ketteringham – Group Payroll and Pensions Manager

Target Date: Not

applicable, recommendation not agreed with.

**5. An incomplete record maintained of IR35 employment status checks
(Recommendation also made in our previous reviews)**

Findings:

A review of the central spreadsheet record used to record, manage and evidence IR35 assessments and outcomes identified that the record had not been maintained in all cases or kept up to date. The record did not therefore provide assurance that checks had been undertaken and that IR35 requirements had been satisfied.

Implications:

Demonstrating compliance in the event of an HMRC inspection or audit review is not possible in the absence of a complete up to date record of employment status checks undertaken.

Agreed Recommendations:

- (i) All incomplete entries in the summary spreadsheet record will be investigated to establish if the required checks have been undertaken. If any cases of non-compliance of IR35 legislation are found, these will be resolved in conjunction with HMRC.
- (ii) Going forward, the summary spreadsheet record will be brought up to date and maintained and be subject to monitoring / supervisory checks. These checks will be evidenced with an electronic signature and date on the spreadsheet record.

Group Payroll and Pensions Manager Comment:

A full record is maintained, evidenced within a central spreadsheet and the off-payroll questionnaire workflow which provides dates and details of assessment and outcomes. The data is already available within the questionnaire workflow, therefore it's likely the central spreadsheet will no longer be utilised as this is secondary to the workflow, however the move to BW use as a database will provide additional support, likely to be implemented Q3 of 2023-24. The new system will automate this process in most cases and provide a more structured recording/reporting mechanism once implemented.

Responsible Officer:

Kate Ketteringham – Group Payroll and Pensions Manager

Target Date:

(i) Central records will be maintained as present between now and transition to using BW, likely to be Q3 2023-24 (ii) Centralised spreadsheet to be ceased and questionnaire workflow data used in conjunction with the BW system for reporting/reporting Q3 2023-24

Limitations inherent to the internal auditor's work

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- Internal control systems, no matter how well designed and operated, are affected by inherent limitations. These include the possibility of poor judgement in decision making, human error, control processes being deliberately circumvented by employees and others, management overriding controls and the occurrence of unforeseeable circumstances.

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- It is management's responsibility to develop and maintain sound systems of risk management, internal control and governance for the prevention and detection of irregularities and fraud. Internal audit work should not be a substitute for management's responsibilities for the design and operation of these systems.
- Internal audit endeavours to plan audit work so that it has a reasonable expectation of detecting significant control weakness and if detected, will carry out additional work directed towards identification of consequent fraud or other irregularities. However, internal audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected.
- Accordingly, these examinations by internal auditors should not be relied upon solely to disclose fraud or other irregularities which may exist.

Stage	Date
Draft issued	17 May 2023
Exit meeting	19 June 2023
Final issued	19 June 2023
ARAC reporting date	30 June 2023
ARAC meeting date	19 July 2023