

Final Internal Audit Report

Agency Use and IR35

September 2023

Distribution: Interim Assistant Chief Executive
Chief People Officer
Head of Human Resources – Resources & Assistant Chief Executive
Head of Human Resources – Adult Social Care and Health
Head of Recruitment
Corporate Director Resources and S151 Officer (Final only)
Director of Finance (Deputy S151)

Assurance Level	Issues Identified	
Limited Assurance	Priority 1	3
	Priority 2	0
	Priority 3	0

Confidentiality and Disclosure Clause

This report ("Report") was prepared by Mazars LLP at the request of London Borough of Croydon and terms for the preparation and scope of the Report have been agreed with them. The matters raised in this Report are only those which came to our attention during our internal audit work. Whilst every care has been taken to ensure that the information provided in this Report is as accurate as possible, Internal Audit have only been able to base findings on the information and documentation provided and consequently no complete guarantee can be given that this Report is necessarily a comprehensive statement of all the weaknesses that exist, or of all the improvements that may be required.

The Report was prepared solely for the use and benefit of London Borough of Croydon and to the fullest extent permitted by law Mazars LLP accepts no responsibility and disclaims all liability to any third party who purports to use or rely for any reason whatsoever on the Report, its contents, conclusions, any extract, re-interpretation, amendment and/or modification. Accordingly, any reliance placed on the Report, its contents, conclusions, any extract, re-interpretation, amendment and/or modification by any third party is entirely at their own risk.

Please refer to the Statement of Responsibility in Appendix 3 of this report for further information about responsibilities, limitations and confidentiality.

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1. Introduction

- 1.1 IR35 is the term used to describe two sets of tax legislation that are designed to combat tax avoidance by workers, and the entities hiring them, who are supplying their services to clients via an intermediary, such as a limited company, but who would be an employee if the intermediary was not used. Such workers are called ‘disguised employees’ by Her Majesty’s Revenue and Customs (HMRC).
- 1.2 IR35 applies where the supplier is an individual, a sole proprietor or business owner, a partnership, an agency staff member or a company (which only has a single person). Breaching this tax legislation will result in Croydon Council (Council) becoming liable for the lost income tax plus any additional charges and penalties from HMRC.
- 1.3 The Council is required to enforce IR35 and is responsible for deciding if off-payroll working rules apply. If the rules apply, the public authority, agency or other third parties who are responsible for paying the worker’s intermediary must deduct employment tax and Class 1 National Insurance Contribution and pay and report these to HMRC.
- 1.4 The Council has an IR35 panel that has been set up to review and assess potential IR35 cases. IR35 panel members consist of the Head of Human Resources and Head of Finance from the relevant department and a Senior Procurement Officer. From 1 January 2022 to 6 July 2022, there were 39 cases being referred to the panel for IR35 assessment.
- 1.5 The Council contracted with Adecco for the supplies of temporary workers across all activities and there are 238 agency workers employed through Adecco as of June 2022. Given the contract with Adecco, it is the expectation that all temporary recruitment would be undertaken through Adecco.
- 1.6 The audit seeks to provide assurance that appropriate controls and processes are in place to ensure that the Council are acting in accordance with the legislation and have mechanisms in place to assess any off payroll working which was taking place.
- 1.7 While our review and testing were performed remotely, we have been able to obtain all relevant documents required to complete the review.
- 1.8 This audit is part of the agreed Internal Audit Plan for 2022/23. The objectives, approach and scope are contained in the Audit Terms of Reference at Appendix 1.

2. Key Issues

Priority 1 Issues

Sample testing found that IR35 panel approval was not evident or applied for eight of the 15 suppliers subject to IR35 assessment before being set up in MyResources. **(Issue 1)**

Status Determination Statements (SDS) were not being produced to inform the IR35 determination. **(Issue 2)**

A check was not in place to confirm if Adecco has an appropriate arrangement for agency workers in accordance with IR35 legislation. **(Issue 3)**

There are no Priority 3 issues.

3. Actions and Key Findings/Rationale

Control Area 2: IR35 Checks, Renewals and Approval

Priority	Action Proposed by Management	Detailed Finding/Rationale - Issue 1
1	<p>Communications will be issued to all managers to confirm the need to identify IR35 status from the outset and prior to the commencement of any supplier engagement or recruitment campaign. This will help to resolve IR35 status issues as early as possible and including the compliance expectations for IR35 status to be confirmed by the IR35 panel prior to any supplier engagement.</p>	<p><u>Expected Control</u></p> <p>For suppliers that meet the condition to be IR35 assessed, IR35 panel approval must be obtained prior to setting up as a supplier in MyResources. An email from the IR35 panel confirming the engagement is outside IR35 must be attached to the supplier set-up request.</p> <p>If IR35 rules apply, Council must account for the Pay As You Earn (PAYE) and National Insurance Contributions (NICs) associated with the contract and the individual/organisation is not allowed to be set up as a supplier.</p> <p><u>Issue/Finding</u></p> <p>Testing of 15 new suppliers, registered in MyResources between 1 April 2021 and 8 July 2022, that were registered under 'limited company' as single Director organisation, and therefore subject to IR35 assessment, noted the following:</p> <ul style="list-style-type: none"> i. For one supplier: This was still being set up as a supplier in MyResources despite the result from Check Employment Status for Tax (CEST) tool determining that IR35 rules apply. (Supplier numbers: 133259) ii. For five suppliers: IR35 panel approval was not obtained for single-director companies (Supplier numbers: 132890, 132345, 131549, 123546 and 123542) iii. For two suppliers: Approval from the IR35 panel was obtained but the email to confirm the approval was not attached to the supplier account in MyResources. (Supplier numbers: 131148 and 129751) <p>Testing of 10 individual suppliers noted:</p>

		iv. For one individual supplier, IR35 panel approval was not obtained. (Supplier number: 131105)
Responsible Officer	Deadline	<u>Risk</u>
Heads of HR Consultancy	31/12/2023	When IR35 procedures are not followed, there is a risk of non-compliance with IR35 legislation. The risk of financial loss to the Council arises when penalties are imposed by HMRC alongside having to pay HMRC the tax and NICs due, as well as any interest due on these amounts.

Control Area 3: Document Retention of IR35 Checks (and Supporting Evidence)

Priority	Action Proposed by Management	Detailed Finding/Rationale - Issue 2
1	Adecco will be asked to provide confirmation that all agency workers have been each assessed and a SDS has been produced to notify of the IR35 determination.	<p><u>Expected Control</u></p> <p>The Finance Bill 2020 included amendments to IR35 and one of the key inclusions was the requirement for end clients to create a document called a Status Determination Statement (SDS). An SDS document showcases how a client has come to an IR35 decision for each of its agency workers. Within the document, the end client must state the worker’s employment status (whether they are inside or outside IR35), and the reasons for this decision must be made clear.</p> <p><u>Issue/Finding</u></p> <p>The Council need to assess the employment status of each agency worker that operates through an intermediary, even if they are provided through an agency, i.e. Adecco (The assessment of employment including the reason for the conclusion must be stated in SDS and given to Adecco and the agency worker.)</p> <p>From the list of agency workers provided by Adecco as of June 2022, there are 238 agency workers engaged at the Council through Adecco. However, we could not obtain a confirmation from management if all agency workers have been each assessed and a SDS has been produced to notify of the IR35 determination.</p>
Responsible Officer	Deadline	<p><u>Risk</u></p> <p>When the Council do not produce an SDS or fails to take reasonable care in the assessment, there is a risk of breaching IR35 legislation. Failure to pass on the SDS to the worker and Adecco will result in the Council being held accountable for the deduction of PAYE tax and NICs to HMRC that are due.</p>
Head of Recruitment	31/7/2023	

Control Area 3: Document Retention of IR35 Checks (and Supporting Evidence)

Priority	Action Proposed by Management	Detailed Finding/Rationale - Issue 3
1	<p>The head of recruitment to put in place processes to ensure Adecco has made the necessary and appropriate deduction for agency workers inside the IR35 scope; and determination for agency workers outside IR35 scope are verified and periodic annual checks to confirm they still remain outside of IR35 scope are undertaken.</p>	<p><u>Expected Control</u></p> <p>In IR35 reforms from April 2021, responsibility for determining the employment status and, if appropriate, operating PAYE and NICs moves from the intermediary to the end-user business.</p> <p><u>Issue/Finding</u></p> <p>Discussion with the Recruitment Manager established that all the agency staff in the Council were engaged through Adecco and if the agency staff were determined as inside IR35, the deduction is made by Adecco.</p> <p>However, we could not obtain a confirmation from the management that: -</p> <ul style="list-style-type: none"> • a check is in place to confirm Adecco has made the necessary and appropriate deduction for agency workers inside the IR35 scope; and • determination for agency workers outside IR35 scope are verified and periodic annual checks to confirm they still remain outside of IR35 scope are undertaken.
Responsible Officer	Deadline	
Head of Recruitment	31/7/2023	<p><u>Risk</u></p> <p>Agency workers may be appointed without following due process and appropriate deductions may not be made prior to the Council making payments. This may result in the HMRC applying penalties. HMRC investigation can be backdated by up to six years, and any owed tax from that period will be claimed back by the government.</p>

TERMS OF REFERENCE

Agency Use and IR35

1 INTRODUCTION

- 1.1 IR35 is the term used to describe two sets of tax legislation that are designed to combat tax avoidance by workers, and the entities hiring them, who are supplying their services to clients via an intermediary, such as a limited company, but who would be an employee if the intermediary was not used. Such workers are called ‘disguised employees’ by Her Majesty’s Revenue and Customs (HMRC).
- 1.2 IR35 applies where the supplier is an individual, a sole proprietor or business owner, a partnership, an agency staff member or a company (which only has a single person). Breaching this tax legislation will result in the Council becoming liable for the lost income tax plus any additional charges and penalties from HMRC.
- 1.3 The Council is required to enforce IR35 and is responsible for deciding if off-payroll working rules apply. If the rules apply, the public authority, agency or other third parties who is responsible for paying the worker’s intermediary must deduct employment tax and Class 1 National Insurance Contribution and pay and report these to HMRC.
- 1.4 The audit seeks to provide assurance that appropriate controls and processes are in place to ensure that the Council are complying with the legislation and have completed a retrospective review of any potential off-payroll working which was taking place.
- 1.5 This audit is part of the agreed Internal Audit Plan for 2022/23.

2 OBJECTIVES AND METHOD

- 2.1 The overall audit objective is to provide an objective independent opinion on the adequacy and effectiveness of controls / processes.
- 2.2 The audit will focus on each control / process being considered:
 - Walkthrough the processes to consider the key controls;
 - Conduct sample testing of the identified key controls, and
 - Report on these accordingly.

3. SCOPE

3.1 This audit included the following areas (and issues raised):





Control Areas/Risks	Issues Raised		
	Priority 1 (High)	Priority 2 (Medium)	Priority 3 (Low)
Legislative, Organisational and Management Requirements	0	0	0
IR35 Checks, Renewals and Approval	1	0	0
Document Retention of IR35 Checks (and Supporting Evidence)	2	0	0
Management Oversight and Reporting	0	0	0
Total	3	0	0

Appendix 2

Definitions for Audit Opinions and Identified Issues

In order to assist management in using our reports:

We categorise our **audit assurance opinion** according to our overall assessment of the risk management system, effectiveness of the controls in place and the level of compliance with these controls and the action being taken to remedy significant findings or weaknesses.

	Full Assurance	There is a sound system of control designed to achieve the system objectives and the controls are constantly applied.
	Substantial Assurance	While there is basically a sound system of control to achieve the system objectives, there are weaknesses in the design or level of non-compliance of the controls which may put this achievement at risk.
	Limited Assurance	There are significant weaknesses in key areas of system controls and non-compliance that puts achieving the system objectives at risk.
	No Assurance	Controls are non-existent or extremely weak, leaving the system open to the high risk of error, abuse and reputational damage.

Priorities assigned to identified issues are based on the following criteria:

Priority 1 (High)	Fundamental control weaknesses that require immediate attention by management to action and mitigate significant exposure to risk.
Priority 2 (Medium)	Control weakness that still represent an exposure to risk and need to be addressed within a reasonable period.
Priority 3 (Low)	Although control weaknesses are considered to be relatively minor and low risk, still provides an opportunity for improvement. May also apply to areas considered to be of best practice that can improve for example the value for money of the review area.

Statement of Responsibility

We take responsibility to the London Borough of Croydon for this report which is prepared on the basis of the limitations set out below.

The responsibility for designing and maintaining a sound system of internal control and the prevention and detection of fraud and other irregularities rests with management, with internal audit providing a service to management to enable them to achieve this objective. Specifically, we assess the adequacy and effectiveness of the system of internal control arrangements implemented by management and perform sample testing on those controls in the period under review with a view to providing an opinion on the extent to which risks in this area are managed.

We plan our work in order to ensure that we have a reasonable expectation of detecting significant control weaknesses. However, our procedures alone should not be relied upon to identify all strengths and weaknesses in internal controls, nor relied upon to identify any circumstances of fraud or irregularity. Even sound systems of internal control can only provide reasonable and not absolute assurance and may not be proof against collusive fraud.

The matters raised in this report are only those which came to our attention during the course of our work and are not necessarily a comprehensive statement of all the weaknesses that exist or all improvements that might be made. Recommendations for improvements should be assessed by you for their full impact before they are implemented. The performance of our work is not and should not be taken as a substitute for management's responsibilities for the application of sound management practices.

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