

Public Interest Report

Essington Parish Council

January 2019



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Summary

Introduction

Smaller Authority Audit Appointments Limited (SAAA) appointed Mazars LLP as the external auditors of Essington Parish Council (the Council) for 2017/18. As appointed auditors, we have a duty to consider whether to issue a report in the public interest when a matter comes to our attention which we believe the Council should consider or the public should know about.

This report constitutes a public interest report under Schedule 7 of the Local Audit and Accountability Act 2014 (the Act). The Act requires the Council to consider this public interest report at a public meeting within one month of the date of this report. The full requirements of Schedule 7 are included as the annex to this report, and the Council should ensure that it complies with all requirements.

Background

On 13 August 2018 the Council received an eligible objection to the 2017/18 accounts from an elector under Section 27 of the Local Audit and Accountability Act 2014. The objection was complex and expressed numerous concerns about the way the Council was managed and led.

Between August and November 2018 we have investigated these concerns and obtained explanations from the Council. We are satisfied that the majority of issues are adequately covered by our audit report, which we have extensively qualified.

However, we have decided that there are grounds for issuing a public interest report in respect of significant non-compliance with VAT regulations, the reasons for which are explained in the next section.

Reasons for this report

The Council is responsible for the use of public funds raised by compulsory taxes. It is accountable to electors as taxpayers and users of council services for how it uses these funds. We identified multiple breaches of HMRC's '*VAT Notice 749: Local authorities and similar bodies*', which provides guidance for local authorities in respect of the VAT Act 1994:

- the Council did not register for VAT until 1 April 2018, although it had operated a tea-room for 4 years so had significant taxable supplies;
- the Council treated the tea-room income as non-business and did not charge output VAT on its sales; and
- the Council's VAT return reclaimed VAT on all of its purchases, which is inappropriate given the above.

The Council has written to HMRC advising them of the non-compliance prior to registration and not yet received a reply or request for repayment. The Council has also held back submitting a claim for the second half of 2017/18 pending HMRC's decision. It has not earmarked reserves or made any provision in the 2017/18 accounts for potential liabilities.

We have issued this report because we believe it is in the public interest to know that a Council has failed to discharge its responsibilities with regard to VAT and is now at risk of a significant backdated tax demand from HMRC. In addition to collecting the amount owing for previous years, HMRC could elect to apply penalties, which may be unaffordable without a significant increase in the precept or negotiated payment terms.

Findings and recommendations

1. VAT Registration

Section 42 of the VAT Act 1994 requires local authorities to register for VAT if they make any taxable supplies (including those that are zero-rated) whatever the value of those supplies. This threshold is considerably lower than that applicable to non-local authority organisations where the threshold was £82,000 in 2015/16, £83,000 in 2016/17 and £85,000 in 2017/18. However, to avoid the administrative costs of maintaining registrations for authorities, it is the practice of HMRC to only enforce this where it is anticipated that output tax will exceed £1,000 a year.

In cases of belated VAT registration, VAT should be accounted for from the effective date of registration i.e. the date registration was required by VAT law. Although the Council did not charge VAT on goods and services from that date, HMRC may demand the VAT which should have been charged. Accordingly, the Council may have to pay the VAT it should have paid since it was required to register without the benefit of the income from tea-room customers, which it would have received if VAT had been correctly charged on sales.

HMRC may also apply a '*late registration penalty*' of 15%. Tea-room income in 2017/18 was £110,000 suggesting a liability of £25,000 for that year alone.

Irrespective of HMRC's approach the Council has exceeded the mandatory threshold applicable to all organisations since 29 February 2016 so the breach is unequivocal and the Council should have identified the need to register for VAT earlier than April 2018.

Prior to VAT registration the Council could, pursuant to s.33 VAT Act 1994, submit a form VAT 126 to HMRC for it to receive a refund of VAT incurred in relation to its non-business activities. VAT incurred in relation to business activities for a non-VAT registered parish council is irrecoverable. However, the Council has annually submitted VAT 126 forms to recover VAT on all expenditure, including that relating to the tea room, as if it were non-business VAT. HMRC may decide to recover VAT previously claimed on all tea-room expenditure. Given that the Council has spent about £30,000 per annum on tea-room supplies this could amount to an additional liability of £24,000 over 4 years.

2. Adequacy of Reserves

Section 2 box 8 of the 2017/18 Annual Governance and Accountability Return (AGAR) indicates that at 31 March 2018 the Council had reserves of £46,365. However, this includes a VAT debtor of £10,018, which is no longer appropriate. Accordingly, the combined effect of provisions for possible repayments to HMRC of output VAT that should have been charged, penalties and VAT inappropriately recovered on business activities could exhaust the Council's reserves. In this worst case scenario it is likely HMRC will agree a phased repayment schedule but the Council will need to earmark reserves each year as part of budget-setting until agreement is reached with HMRC and the net liability and timing of repayments are known.

The preparation of an annual budget is one of the key statutory tasks to be undertaken by a Council. The budget has three main purposes:

- it results in the Council setting the precept for the year, which impacts on local council tax bills;
- it allows spending commitments to be made in accordance with plans approved by members; and
- it provides a basis for monitoring progress during the year by comparing actual spending against planned spending.

It is essential that members understand how the budget is put together and how it is to be used. Reviewing the budget against actual expenditure

regularly gives members early warning about the likelihood of a shortfall and helps them take early remedial action.

The Council approved its 2018/19 budget on 12 March 2018. The budget was balanced but included no provision for potential VAT liabilities and the precept was not increased. This was shortly before the Council sought advice on the VAT position of the tea-room and determined that it should have registered. Accordingly, the budget reflected the best information available to the Council. However, we believe that the Council should have taken professional advice on VAT when the tea-room was set up in 2014 and again when the 2016/17 AGAR was qualified in respect of a separate VAT issue, which was well in advance of approving the 2018/19 budget.

The Council is obliged to comply with proper practices in preparing its statement of accounts under regulation 11 of the Accounts and Audit Regulations 2015. Proper practice set out in Paragraph 1.39 of the Practitioner's Guide (*'Governance and Accountability for Smaller Authorities in England 2018'*) requires that smaller authorities consider if any significant events occurred during the financial year (or after the year-end but before the approval of the AGAR) have consequences or potential consequences on the authority's finances. Any such events may require provision in the statement of accounts and revision to the budget. When the Council identified its multiple breaches of VAT regulations it did not reflect the significant event in the accounts or amend the budget. The event does not appear to have been formally discussed at a council meeting until November 2018.

3. Summary and conclusions

We welcome the Council's VAT registration and transparent correspondence with HMRC. However, the lack of compliance is a significant governance weakness.

Corporate governance underpins how parish councils operate. Without strong corporate governance arrangements fraud and error can go undetected and the Council will be unable to ensure that it effectively directs and controls the provision of services to residents. Public bodies and their management share responsibility for discharging their responsibilities for governance, accountability and transparency.

VAT is a complex area and smaller authorities often need to seek specialist advice from accountants or their representative bodies to ensure

compliance with regulations. We are satisfied that this advice was taken in April 2018 and registration followed promptly. However, we are concerned that advice was not taken considerably earlier, preferably when the tea-room was established in 2014 and certainly soon after the external audit report on the 2016/17 AGAR. Earlier action would have reduced or eliminated the potential liabilities and allowed the 2017/18 accounts and 2018/19 budget to better reflect the challenging financial position that the Council now finds itself in.

4. Recommendations

As the Council has acted to address the weaknesses above we have not made any statutory recommendations under Schedule 7 of the Local Audit and Accountability Act. However, we recommend that the Council establishes the worst case scenario in terms of VAT liabilities and makes appropriate provision in the 2018/19 AGAR accounting statements and 2019/20 budget setting.

Annex 1: Extract of the Local Audit and Accountability Act (2014)

SCHEDULE 7 REPORTS AND RECOMMENDATIONS

Public interest reports

1(1) A local auditor of the accounts of a relevant authority must consider whether, in the public interest, the auditor should make a report on any matter coming to the auditor's notice during the audit and relating to the authority or an entity connected with the authority, so it can be considered in accordance with this Schedule or brought to the public's attention.

(2) A report under sub-paragraph (1) is referred to in this Act as a public interest report.

(3) A public interest report may be made during or after the end of an audit.

(4) A local auditor must notify a relevant authority's auditor panel (if it has one) as soon as is reasonably practicable after making a public interest report relating to the authority or an entity connected with it.

(5) A local auditor may recover from a relevant authority—

(a) the reasonable costs of determining whether to make a public interest report relating to the authority or an entity connected with it, and

(b) the reasonable costs of making a public interest report relating to the authority or an entity connected with it.

(6) Sub-paragraph (5)(a) applies regardless of whether the report is in fact made.

Written recommendations

2(1) A local auditor of the accounts of a relevant authority may make a written recommendation to the authority relating to the authority or an entity connected with it, so that the recommendation can be considered under this Schedule.

(2) A recommendation may be made during or at the end of an audit.

(3) A recommendation must be sent at the time it is made—

(a) to the Secretary of State,

(b) where the recommendation relates to an entity connected with the relevant authority, to that entity and to any other relevant authority with which the entity is connected,

(c) where the relevant authority is itself a connected entity, to its related authority or authorities,

(d) where the relevant authority is a clinical commissioning group, to the National Health Service Commissioning Board, and

(e) where the relevant authority is—

(i) a functional body,

(ii) an entity connected with a functional body, or

(iii) the London Pensions Fund Authority,

to the Greater London Authority.

(4) A local auditor may recover from a relevant authority—

(a) the reasonable costs of determining whether to make a recommendation relating to the authority or an entity connected with it, and

(b) the reasonable costs of making a recommendation relating to the authority or an entity connected with it.

(5) Sub-paragraph (4)(a) applies regardless of whether the recommendation is in fact made.

(6) In this Act “related authority”, in relation to a connected entity, means the relevant authority with which the entity is connected.

Supply of public interest reports

3(1) If a local auditor makes a public interest report arising out of the audit of the accounts of a relevant authority, the auditor must send the report to—

(a) the authority, and

(b) where the report relates to an entity connected with the authority, to that entity and to any other relevant authority with which the entity is connected.

(2) The local auditor must also send the report—

(a) to the Secretary of State,

(b) where the relevant authority is itself a connected entity, to its related authority or authorities,

(c) where the relevant authority is a clinical commissioning group, to the National Health Service Commissioning Board, and

(d) where the relevant authority is—

(i) a functional body,

(ii) an entity connected with a functional body, or

(iii) the London Pensions Fund Authority,

to the Greater London Authority.

(3) A report required to be sent under sub-paragraph (1) or (2) must be sent as soon as is reasonably practicable after it is made.

(4) If a relevant authority to which a report is sent under this paragraph is a health service body, it must take the report into consideration as soon as is reasonably practicable after receiving it.

(5) If paragraph 5 applies to a relevant authority to which a report is sent under this paragraph, it must, if required by that paragraph to do so, take the report into consideration in accordance with that paragraph.

(6) If a relevant authority to which a report is sent under this paragraph is the Greater London Authority, it must, if required by that paragraph to do so, take the report into consideration in accordance with paragraph 6.

Publicity for public interest reports

4(1) This paragraph applies to a relevant authority if a local auditor has made a public interest report relating to the authority or an entity connected with it.

(2) As soon as is practicable after receiving the report, the relevant authority must publish the report and a notice that—

(a) identifies the subject matter of the report, and

(b) unless the authority is a health service body, states that any member of the public may inspect the report and make a copy of it or any part of it between the times and at the place or places specified in the notice.

(3) As soon as is practicable after receiving the report, the relevant authority must supply a copy of the report to—

(a) each of its members (if it has members), and

(b) its auditor panel (if it has one).

- (4) Sub-paragraph (3)(a) does not apply in relation to a parish meeting.
- (5) From the time when the report is received, the relevant authority, unless it is a health service body, must ensure that any member of the public may—
- (a) inspect the report at all reasonable times without payment,
 - (b) make a copy of it, or any part of it, and
 - (c) be supplied with a copy of it, or any part of it, on payment of a reasonable sum.
- (6) The local auditor may—
- (a) notify any person the auditor thinks fit of the fact that the auditor has made the report, and
 - (b) supply a copy of it or any part of it to any person the auditor thinks fit.
- (7) A notice or report required to be published under this paragraph must be published—
- (a) if the authority has a website, on its website;
 - (b) otherwise, in accordance with sub-paragraph (8).
- (8) A relevant authority publishes a notice or report in accordance with this sub-paragraph if—
- (a) in the case of an authority other than a health service body, it publishes the notice or report in such manner as it thinks is likely to bring the notice or report to the attention of persons who live in its area;
 - (b) in the case of a clinical commissioning group, it publishes the notice or report in such manner as it thinks is likely to bring the notice or report to the attention of—
 - (i) persons who live in the area of the group, and

- (ii) persons who do not live in the area of the group but for whom the group is responsible;
 - (c) in the case of special trustees for a hospital, they publish the notice or report in such manner as they think is likely to bring the notice to the attention of persons to whom services are provided at that hospital.
- (9) Nothing in this paragraph affects the operation of paragraph 9.

Consideration of report or recommendation

- 5(1) Subject to sub-paragraphs (2) and (4), this paragraph applies to a relevant authority if—
- (a) a local auditor has made a public interest report relating to the authority or an entity connected with it, or
 - (b) a local auditor has made a recommendation relating to the authority or an entity connected with it.
- (2) This paragraph does not apply to a relevant authority which is itself a connected entity, subject to sub-paragraph (3).
- (3) This paragraph applies to the Mayor's Office for Policing and Crime where a local auditor has made a report or recommendation relating to the Commissioner of Police of the Metropolis regardless of whether the Office is a connected entity or was such an entity at the time to which the report or recommendation relates.
- (4) This paragraph does not apply to—
- (a) the Greater London Authority (but see paragraph 6), and
 - (b) health service bodies.

(5) The relevant authority must consider the report or recommendation at a meeting held before the end of the period of one month beginning with the day on which it was sent to the authority.

(6) At that meeting the relevant authority must decide—

(a) whether the report requires the authority to take any action or whether the recommendation is to be accepted, and

(b) what, if any, action to take in response to the report or recommendation.

(7) Where the relevant authority is a police and crime commissioner or the Mayor's Office for Policing and Crime, the authority must, before the end of the period of one month beginning with the day on which the report or recommendation was sent to the authority, decide—

(a) whether the report requires the authority to take any action or whether the recommendation is to be accepted, and

(b) what, if any, action to take in response to the report or recommendation.

(8) If the local auditor is satisfied that it is reasonable to allow more time for the relevant authority to comply with sub-paragraph (5) or (7), the auditor may extend or further extend the period of one month mentioned in that sub-paragraph.

(9) This paragraph does not affect any duties (so far as they relate to the subject-matter of a report or recommendation sent to a relevant authority) which are imposed by or under—

(a) this Act,

(b) sections 114 to 116 of the Local Government Finance Act 1988 (functions and reports of finance officers),

(c) section 5 of the Local Government and Housing Act 1989 (functions of monitoring officers), or

(d) any other enactment.

(10) The Secretary of State may by regulations provide for this paragraph to apply with modifications in relation to a relevant authority specified, or of a description specified, in the regulations.

(11) The Secretary of State may by regulations provide for any provisions of the following that do not otherwise apply to a meeting of a relevant authority under this paragraph to apply (with or without modifications) to such a meeting—

(a) the Public Bodies (Admission to Meetings) Act 1960;

(b) Part 5A of the Local Government Act 1972 (access to meetings and documents);

(c) Schedule 12 to that Act (meetings and proceedings of local authorities).

Consideration of report or recommendation: Greater London Authority

6(1) This paragraph applies if—

(a) a local auditor has made a public interest report relating to the Greater London Authority ("the Authority") or an entity connected with it, or

(b) a local auditor has made a recommendation relating to the Authority or an entity connected with it.

(2) This paragraph does not apply where a local auditor has made a report or recommendation relating to the Commissioner of Police of the Metropolis regardless of whether the Commissioner is connected with the Authority or was so connected at the time to which the report or recommendation relates.

- (3) The London Assembly (“the Assembly”) must consider the report or recommendation at a meeting.
- (4) The Mayor of London (“the Mayor”) must attend the meeting.
- (5) At the meeting, the Assembly must decide what recommendations to make to the Mayor about the decisions to be made under sub-paragraph (6).
- (6) Having considered the report or recommendation, and the Assembly’s recommendations under sub-paragraph (5), the Mayor must decide—
- (a) whether the report requires the Authority to take any action or whether the recommendation is to be accepted, and
- (b) what, if any, action to take in response to the report or recommendation.
- (7) The Mayor and the Assembly must comply with sub-paragraphs (3) to (6) before the end of the period of one month beginning with the day on which the report or recommendation was sent to the Authority.
- (8) If the local auditor is satisfied that it is reasonable to allow more time for the Mayor or the Assembly to comply with sub-paragraphs (3) to (6), the auditor may extend or further extend the period of one month mentioned in sub-paragraph (7).
- (9) This paragraph does not affect any duties (so far as they relate to the subject-matter of a report or recommendation sent to the Authority) which are imposed by or under—
- (a) this Act,
- (b) sections 114 to 116 of the Local Government Finance Act 1988 (functions and reports of finance officers),
- (c) section 5 of the Local Government and Housing Act 1989 (functions of monitoring officers), or

(d) any other enactment.

Bar on delegation of functions relating to meetings

7(1) If a relevant authority is a local authority operating executive arrangements, the authority’s functions under paragraph 5 are not the responsibility of an executive of the authority under those arrangements.

(2) If a relevant authority is a local authority within the meaning of section 101 of the Local Government Act 1972 (arrangements for discharge of functions), that section does not apply to its functions under paragraph 5.

(3) The functions of a parish meeting under paragraph 5 are to be exercised by the parish meeting itself (and not by its chairman on behalf of the parish meeting).

(4) Any functions of the Mayor of London under paragraph 6 must be exercised by the Mayor personally.

(5) Section 54 of the Greater London Authority Act 1999 (discharge of London Assembly functions by committees etc) does not apply in relation to any function of the London Assembly under paragraph 6.

Publicity for meetings

8(1) If a relevant authority is required to hold a meeting under paragraph 5, it must publish a notice in compliance with sub-paragraphs (2) to (4).

(2) The notice must be published—

(a) if the relevant authority has a website, on its website;

(b) otherwise, in such manner as the authority thinks is likely to bring the notice to the attention of persons who live in its area.

(3) The notice must—

(a) state the time and place of the meeting,

- (b) indicate that the meeting is to be held to consider a local auditor's report or recommendation (as the case may be),
 - (c) if the meeting is to be held to consider a report, describe the subject matter of the report, and
 - (d) if the meeting is to be held to consider a recommendation, set out the recommendation or, where this is not reasonably practicable, describe its subject matter.
- (4) The notice must be published before the beginning of the period of 8 days ending with the day of the meeting.
- (5) The agenda supplied to the members of the relevant authority for the meeting must be accompanied by a copy of the report or recommendation (as the case may be).
- (6) Sub-paragraph (5) does not apply in relation to a parish meeting.
- (7) If the London Assembly is required to hold a meeting under paragraph 6, the Greater London Authority must publish on its website a notice in compliance with sub-paragraphs (3) and (4).
- (8) The agenda supplied to the members of the London Assembly for the meeting must be accompanied by a copy of the report or recommendation (as the case may be).
- (9) This paragraph applies in addition to any provision made in relation to the relevant authority in question by or under the Public Bodies (Admission to Meetings) Act 1960, the Local Government Act 1972 or any other enactment.

Access to meetings and documents

9(1) Where a public interest report or a recommendation is to be considered under paragraph 5 by a relevant authority to which the Public Bodies (Admission to

Meetings) Act 1960 applies, the report or recommendation is not to be excluded from the matter supplied under section 1(4)(b) of that Act (supply of agenda etc to newspapers).

(2) Part 5A (access to meetings and documents) of the Local Government Act 1972 applies to a meeting of the London Pensions Fund Authority under paragraph 5 as if the Authority were a principal council.

(3) Sub-paragraphs (4) to (6) apply in relation to the consideration under paragraph 5 or 6 of a public interest report or a recommendation by a relevant authority to which Part 5A (access to meetings and documents) of the Local Government Act 1972 applies.

(4) Information contained in the report or recommendation is not to be treated as exempt information for the purposes of that Part.

(5) The report or recommendation is not to be excluded—

(a) from the documents open to inspection under section 100B(1) of that Act (public access to agenda and reports before meetings), or

(b) from the matter supplied under section 100B(7) of that Act (supply of agenda etc to newspapers).

(6) Part 5A of the Local Government Act 1972 has effect in relation to the report or recommendation as if section 100C(1)(d) of that Act (public access to copies of reports for six years after meeting) were not limited to so much of the report or recommendation as relates to an item during which the meeting was open to the public.

(7) Information contained in a public interest report or a recommendation is not to be treated as exempt information for the purposes of any Act or instrument made

under an Act that applies in relation to exempt information within the meaning of Part 5A of the Local Government Act 1972.

(8) References in this paragraph to a public interest report or a recommendation include any report on the report or recommendation.

Publicity for decisions under paragraph 5 or 6

10(1) As soon as is practicable after making decisions under paragraph 5(6) or (7) or 6(6), a relevant authority must—

(a) notify the authority's local auditor of those decisions, and

(b) publish a notice containing a summary of those decisions which has been approved by the auditor.

(2) The notice under sub-paragraph (1)(b) must be published—

(a) if the relevant authority has a website, on its website;

(b) otherwise, in such manner as the authority thinks is likely to bring the notice to the attention of persons who live in its area.

(3) The notice required by sub-paragraph (1)(b) in relation to a meeting need not summarise any decision made while the public were excluded from the meeting—

(a) as the result of a resolution under section 1(2) of the Public Bodies (Admission to Meetings) Act 1960 (protection of public interest),

(b) under section 100A(2) of the Local Government Act 1972 (confidential matters), or

(c) as the result of a resolution under section 100A(4) of that Act (exempt information).

(4) If sections 100C and 100D of the Local Government Act 1972 (availability for inspection after meetings of minutes etc) apply in relation to a meeting under paragraph 5 or 6, the notice required by sub-paragraph (1)(b) must indicate the documents in relation to the meeting that are open for inspection in accordance with those paragraphs.

(5) This paragraph applies in addition to any provision made in relation to the relevant authority by or under the Public Bodies (Admission to Meetings) Act 1960, the Local Government Act 1972 or any other enactment