

Revenue Scotland

Interim Audit Report 2016/17



 AUDIT SCOTLAND

Prepared for Revenue Scotland

May 2017

Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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Audit findings

Introduction

1. This report contains a summary of the key issues identified during the interim audit work carried out at Revenue Scotland. This work included reviewing and updating our understanding and testing of key controls, covering the financial systems provided under a shared service agreement by the Scottish Government and the tax collection and administration system, the Scottish Electronic Tax System (SETS). We also followed up on the matters raised in our 2015/16 interim audit report (issued June 2016) including matters raised in relation to the SETS system.

2. The purpose of the testing of key financial controls is to gain assurance over the processes and systems used in preparing the financial statements. We will use the results of this testing to determine our approach during the 2016/17 financial statements' audit.

3. Our responsibilities under the Code of Audit Practice require us to assess the system of internal control put in place by management. We seek to gain assurance that Revenue Scotland:

- has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements
- has systems of internal control which provide an adequate means of preventing and detecting error, fraud or corruption
- complies with established policies, procedures, laws and regulations.

4. As part of our responsibilities under the Code of Audit Practice (2016), and as outlined in our annual audit plan (submitted in February 2017), we are required to undertake wider dimension work across four audit dimensions: financial management, financial sustainability, governance and transparency and value for money.

5. Our work is progressing in these areas, which includes a follow-up of our 2010 Role of Boards Report. We will report our findings from our wider dimension work in our Annual Audit Report, which we will present to the September 2017 Audit and Risk Committee.

Conclusion

6. We are pleased to record that in relation to the matters raised in our 2015/16 interim report:

- good progress has been made in developing processes for checking the accuracy of tax calculations. Staff have continued to develop their experience and knowledge and are better placed to identify and investigate those tax returns most at risk from error or fraud
- good progress has been made around the management of the SETS contract: the contract has been renewed and regular reports are being provided by the supplier on system performance

- arrangements have been introduced to ensure the continuing provision of IT services in the event of a failure in the tax collection system (SETS). A verified ESCROW arrangement has been established which will permit the independent re-building of the system in the event of failure or the supplier going out of business and not being able to support the system any longer
- segregation of duties within the finance section has improved due to increased resourcing and subsequent widening of responsibilities.

7. Our testing on the tax collection system (Scottish Electronic Tax System {SETS}) established that progress has been made around the management of the SETS contract since our previous review (see paragraph 6 above). Our review of tax compliance activity established that there remains scope for improvement as many areas continue to develop. We have made a number of recommendations for improving compliance activity which are outlined in [Exhibit 1](#).

8. In respect of our audit of the devolved taxes account, we have taken limited assurance from our interim work and will supplement our approach with additional year end testing as noted in paragraph 19 below.

9. In respect of our testing in relation to the Resource Accounts, no significant control weaknesses were identified on those systems operated on behalf of Revenue Scotland by the Scottish Government. We identified one area for improvement on accounts payable which we have summarised in [Exhibit 1](#) overleaf. This will enable us to take planned assurance on these systems for our audit of the 2016/17 financial statements.

10. The matters raised in this report should be considered as part of the Accountable Officer's assessment of the review and adequacy of the financial governance processes in place to support the Annual Governance Statements in both the Resource and Devolved Taxes Accounts.

Work summary

11. Our 2016/17 testing of the Resource accounts covered key controls in a number of areas including bank reconciliations, payroll validation and exception reporting, authorisation of journals, change of supplier bank details and IT access controls. Additionally, our testing covered budget monitoring and control, feeder system reconciliations and controls for preventing and detecting fraud in areas such as taxation receipts.

12. Our 2016/17 testing of the Devolved Taxes Account included a follow up to the matters raised in our 2015/16 interim report, a review of tax compliance activity and an update on the SETS system.

13. We also undertook a high level review the ICT arrangements covering the SETS system which is crucial to the delivery of Revenue Scotland services.

14. In accordance with *ISA 330: the auditor's response to assessed risk*, our audit judgements are based on current year testing of controls and where appropriate prior year results. Our risk based audit approach allows us to take a three-year cyclical approach to controls testing. This approach enables us to place reliance on previous years' audit work where controls remain unchanged and no significant weaknesses had been identified.

15. As outlined in our Annual Audit Plan, we sought to place reliance on the work of internal audit. We reviewed internal audit's work on Budget Management, Business Continuity Planning and Debt Collection Arrangements (follow-up). We were unable to place reliance on the Tax Governance and Compliance Review due to the timing of the work.

16. The contents of this report have been discussed with management to confirm factual accuracy. The co-operation and assistance we received during the course of our audit is gratefully acknowledged.

Risks identified

17. The key control risks identified during the interim audit are detailed in [Exhibit 1](#). As outlined below, these findings will inform our approach to the financial statements audit where relevant.

18. Any weaknesses identified represent those that have come to our attention during the course of normal audit work and therefore are not necessarily all the weaknesses that may exist. It is the responsibility of management to decide on the extent of the internal control system appropriate to Revenue Scotland.

Additional follow-up work

19. Our interim testing has identified additional audit work to be carried out at final accounts stage. Our sample testing of tax returns will include examination of voided returns, the designation of properties as non-residential for LBTT purposes and the operation of charities relief. In addition, we plan to examine reconciliations on the SETS to SEAS interface and carry out some payroll checks on starters and leavers.

Exhibit 1

Key findings and action plan 2016/17

Issue identified	Management response	Responsible officer and target date
Audit findings: ICT review		
<p>SETS system back-up and recovery</p> <p>Revenue Scotland collects and administers tax revenues using the SETS system which is provided by an external supplier.</p> <p>In accordance with the agreement, the supplier takes back-ups of the system on a regular basis. A disaster recovery exercise was undertaken by the supplier in May 2016 based on the potential loss of the primary data centre. This was a 'table top' exercise and was not conducted in a 'live' environment. Disaster recovery testing should be undertaken on a regular basis and reviewed by Revenue Scotland.</p> <p>We acknowledge that Revenue Scotland has introduced a range of measures to ensure business continuity and that conducting this testing in a live environment would be a time consuming exercise.</p> <p>In the absence of a test undertaken in a 'live' environment, there remains a risk that Revenue</p>	<p>Agreed</p> <p>As part of the management of the contract, regular oversight of activities, like disaster recovery, is part of the quarterly agenda. We shall explore the feasibility of undertaking a live disaster recovery exercise with our supplier while recognising the operational implications.</p>	<p>Head of Strategy & Corporate Functions</p> <p>December 2017</p>

Issue identified	Management response	Responsible officer and target date
<p>Scotland's recovery processes are not sufficiently robust, leaving Revenue Scotland's operations exposed in the event of system failure.</p> <p>Controls Assurance - SETS</p> <p>Under the terms of the contract Revenue Scotland leases the SETS system. Some management assurance over this service is obtained through quarterly management meetings and service reports covering, amongst others, issues and incidents, and capacity. As further devolved taxes are assigned to Revenue Scotland, the SETS system will see an increase in the number of transactions it supports and the complexity of data held.</p> <p>Revenue Scotland should therefore consider seeking <i>independent</i> assurance over the SETS service in future, using a generally accepted framework. A possible solution would be to commission an ISAE3402 report - Assurance Reports on Controls at a Service Organisation. This would provide much wider assurance over the supplier's operations than just service delivery. It would cover design and/or operation of controls, standard operating procedures in place, back-up and recovery and user management controls which currently have not been independently verified.</p> <p>Looking ahead, there is a potential risk to Revenue Scotland's operations without adequate independent assurance over the supplier's operation of the SETS system.</p>	<p>Accept</p> <p>We shall consider building in appropriate additional independent verification and assurance into the new replacement contract for SETS.</p> <p>In the interim, in November 2016 we undertook a site visit to the supplier to verify compliance with key security controls. Furthermore the current supplier of SETS is ISO 27000 accredited.</p>	<p>Head of Strategy & Corporate Functions</p> <p>March 2018</p>
<p>Audit findings: Follow up to 2015/16 interim report</p>		
<p>Sample checks of tax returns</p> <p>We reported in 2015/16 that Revenue Scotland should introduce a monthly quality control process whereby a sample (based on a percentage) of returns was checked and errors recorded - this would provide information on taxpayer error rates and identify areas (or agents) more prone to error.</p> <p>Our review this year has found that a retrospective sampling exercise has been undertaken on 2015/16 LBTT tax returns, covering 4 high-level</p>	<p>Partly accept</p> <p>The random sampling process for LBTT returns has two primary functions. Firstly, it tests the integrity of our risk based approach. Secondly, it acts as a deterrent because taxpayers and agents know that there is a possibility their returns will be selected for enquiry. It therefore has a preventative function as well as a corrective one.</p> <p>Random enquiries are by their nature, not intended to target areas of known risk because these form part of our risk based</p>	<p>Head of Tax</p> <p>September 2017</p>

Issue identified	Management response	Responsible officer and target date
<p>categories of return. A total of 132 returns were sampled from which 43 required further review: a few of these have led to enquiries being opened. Work has now commenced on a sample of 2016/17 LBTT returns.</p> <p>In order to further refine the approach to tax compliance, we recommend that Revenue Scotland considers:</p> <ul style="list-style-type: none"> • increasing the sample sizes to give a greater degree of assurance over accuracy • adopting a more targeted approach to include known high risk areas • carrying out the checks on a more regular basis <p>There is a risk that limited assurance can be taken, based on the current approach, to provide a sufficient degree of assurance over the accuracy of tax returns.</p>	<p>approach to compliance. We have however structured the selection process for random case selection to ensure that we sample across the full range of transaction types including residential and non-residential and lease and conveyance transactions.</p> <p>No significant risks have been identified as a result of the random enquiries undertaken to date that we are not already targeting through our risk based approach to compliance.</p> <p>We will undertake a review of our random enquiry programme and base any decision on whether to increase the sample size or frequency on the outcome of that.</p>	
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<p>Compliance strategy</p> <p>In our 2015/16 report we recommended that Revenue Scotland consider developing an exception reporting function to identify unusual or high risk cases for further investigation.</p> <p>We are aware that tax compliance strategies are currently being drafted in light of Revenue Scotland's operational experience to date which should help to clarify data requirements including the use of exception reporting.</p> <p>The development of compliance strategies to direct work to risk areas should enhance the efficacy of compliance activity. This should include maximising the use of in-house data resources, making better use of shared data and enhancing analytical and reporting functions.</p> <p>There is a risk that without a more strategic, intelligence-led approach to tax compliance work, that work may lack focus which increases the risk of fraud or error being missed.</p>	<p>Accept</p> <p>Work on developing our compliance strategy for LBTT is well advanced and we are aiming to complete this within the first quarter of the current year. We will however keep it under constant review and add to and enhance it in the light of future experience.</p> <p>We recognise that both our in-house and our shared data sources will be critical in enabling us to identify and target risks and measure the effectiveness of our compliance strategy.</p> <p>Following the successful recruitment of staff to the Tax Administration team, we anticipate an increase in resources available for the lower level of compliance activity including corrections and the simplest enquiries. We will also use our compliance strategy to direct resources effectively and proportionately to the risks identified.</p>	<p>Head of Tax September 2017</p>
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<p>Data sharing and improved use of in-house tax data</p> <p>We are pleased to note that Revenue Scotland now has a data sharing agreement with HMRC to perform data analysis on potential ADS transactions</p>	<p>Accept</p> <p>We are committed to working with RoS to achieve a better match of our respective</p>	<p>Head of Strategy & Corporate Functions</p>

Issue identified	Management response	Responsible officer and target date
<p>that have not been returned to Revenue Scotland.</p> <p>We recommended in 2015/16 that Revenue Scotland make better use of the monthly purchase data from Registers of Scotland (RoS) as a check on property consideration amounts and transaction dates recorded in SETS. Management agreed to look into ways of making more use of this data to support their compliance work.</p> <p>As part of our 2016/17 review we found there had been limited progress made due to poor match-rates between RoS and SETS data.</p> <p>Revenue Scotland should seek to develop a data strategy which will make use of RoS reports on LBTT transactions and HMRC data to assist compliance activity. Revenue Scotland should also seek to develop internal data analytics procedures as it builds up its own operational database on the devolved taxes.</p> <p>These activities will serve to identify and thereby enhance compliance efficiency and effectiveness.</p> <p>There is a risk to the collection of tax revenues where supporting data and evidence is not being used to enhance compliance activity.</p>	<p>data, starting by finding out how they match our tax return data to their land registry data.</p> <p>We are in the process of developing a data analysis strategy for the organisation and initial proposals were presented to the Board in April. This will ensure more effective use of the data available to us.</p>	<p>March 2018</p>

Audit findings: financial controls

Amendments to supplier records

Our 2016/17 audit testing of supplier amendments found one instance where a new supplier request form had not been authorised appropriately.

There is a risk that payments are made to non-valid suppliers if the agreed procedures are not followed.

Accepted

We have reminded staff of the need to follow procedures.

Head of Strategy & Corporate Functions
Completed

Wider dimension issues and risks

Staff resources

At the time of our audit review, staff resources in the tax administration team were under particular pressure due to the level of vacancies. The level of vacancies appears to have impacted on progress with aspects of compliance work during 2016/17. It has also delayed the completion of developing desk instructions and in-house process guidance.

We are aware that management have

Agreed

The delay in recruiting has impacted upon some aspects of Revenue Scotland operations. However, all key business objectives were met in 2016/17 as a result of careful management of the risks associated with restructuring.

A new structure was announced in August 2016 to improve the effectiveness of Revenue Scotland.

Chief Executive
Ongoing

Issue identified	Management response	Responsible officer and target date
<p>been in close contact with the Scottish Government in order to consider alternative approaches to the recruitment of specialist skills.</p> <p>There is a risk that a high level of vacancies could adversely affect operations.</p>	<p>A recruitment and resourcing strategy was prepared to complement the announcement of the new structure. The strategy supported strategic planning to ensure that resources and skills mix were matched to business priorities to ensure that the organisation continued to meet its Business Plan Objectives and KPIs during the recruitment phase.</p> <p>As at end May 2017, all but 4 of the vacant posts were appointed. These posts related to either the administration of Air Departure Tax (which was still subject to legislative approval) or wider corporate functions.</p>	

Source: Audit Scotland

20. All our outputs and any matters of public interest will be published on our website: www.audit-scotland.gov.uk.

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: 0131 625 1500 E: info@audit-scotland.gov.uk
www.audit-scotland.gov.uk