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Archwilydd Cyffredinol Cymru  
Auditor General for Wales

# Financial Management and Governance in Community Councils 2015-16



WALES AUDIT OFFICE  
SWYDDFA ARCHWILIO CYMRU





The team who prepared this report comprised  
Anthony Barrett and Deryck Evans.

**Huw Vaughan Thomas**  
**Auditor General for Wales**  
**Wales Audit Office**  
**24 Cathedral Road**  
**Cardiff**  
**CF11 9LJ**

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Mae'r ddogfen hon hefyd ar gael yn Gymraeg.

# Contents

	<b>Summary report</b>	<b>6</b>
<b>1</b>	<b>Community councils in Wales manage significant sums of public money and hold significant values of reserves and assets and this is likely to increase in future</b>	<b>11</b>
	In 2015-16 community councils received over £43 million of income and incurred over £40 million of expenditure	11
	Community councils in Wales manage reserves worth over £32 million and long term assets worth over £188 million	13
	A significant proportion of the total income, expenditure and assets of the sector is concentrated in the larger councils which are subject to the requirements of the Well-Being of Future Generations Act	14
<b>2</b>	<b>Too many community councils in Wales receive avoidable qualified audit opinions and this is particularly the case with smaller councils</b>	<b>15</b>
	Auditors issue 'qualified' audit opinions when councils fail to comply with their statutory responsibilities	15
	Over 200 individual councils (30%) received a qualified audit opinion for 2015-16	15
	A disproportionate number of smaller councils received qualified audit opinions suggesting there is a particular need for these councils to review their arrangements	16
	The most common audit qualifications relate to the failure to adhere to the statutory timetable for the accounts, to put in place arrangements to manage risk, and to set an appropriate budget	17
<b>3</b>	<b>Community councils in Wales need to improve the timeliness with which they prepare their annual accounts and the quality of the annual returns submitted for audit</b>	<b>19</b>
	Over 50 councils (8%) failed to comply with the statutory timetable for preparing and approving the accounting statements	19
	Too many councils submit annual returns that are incomplete or contain simple errors in the accounts	21
<b>4</b>	<b>The sector as a whole needs to improve its budget setting arrangements if it is to manage additional services and facilities transferred from unitary authorities, and this is particularly the case for smaller councils</b>	<b>24</b>
	For the 2015-16 audit, auditors have focused on how councils have set and monitored their budgets	24
	Over a third (36%) of councils did not set an appropriate budget including all the elements they are required to include by law	25
	Over half of all councils do not have adequate budget monitoring arrangements in place	27

<b>5</b>	<b>Many community councils will find it difficult to demonstrate that they have an adequate and effective system of internal audit in place and receive full value from that service</b>	<b>29</b>
	For the 2015-16 audit , auditors focused on the terms of reference for internal audit	29
	A majority of councils did not have full terms of reference in place for their internal audit	30
	Almost a third of community councils also lack any detailed feedback from their internal auditor meaning they do not receive the full value from the internal audit service	31
	In some cases, internal audit drew different conclusions to those of the external auditor suggesting that the work undertaken by internal audit was insufficient	32
<b>6</b>	<b>Auditors reported on a number of recurring matters that councils across Wales could learn from</b>	<b>33</b>
	Many councils do not follow the basic procedural requirements set out in law	33
	Auditors noted recurring issues related to councils' potential non-compliance with the law that could have a financial impact on individual councils	34
	Some councils hold significant levels of financial reserves without a clear purpose as to why those reserves are held	36
	In many cases, councils need to make significant improvements to the records of the long term assets they hold	37
<b>7</b>	<b>Since the publication of the Auditor General's report on the 2014-15 accounts, auditors have exercised statutory powers to make formal recommendations to a small number of councils</b>	<b>38</b>
	Auditors made written recommendations to improve councils' financial management and compliance with statutory requirements	38
<b>8</b>	<b>The Auditor General's audit programme for 2016-17 to 2020-21 will continue to focus on areas where there is scope for community councils to improve their financial management and governance</b>	<b>40</b>
	For the 2016-17 audit, auditors will focus on the arrangements councils have made to adopt a Code of Conduct for members and to ensure they are properly dealing with payroll issues	40
	For the 2017-18 audit, auditors will focus on the effectiveness of internal audit and how councils manage their reserves and balances	41
	Looking forward to 2018-19 and beyond, the Auditor General's programme will continue to look at common issues arising during the annual audit, and will also incorporate a review of the sector's response to the Well-Being of Future Generations Act 2015	42

# Summary report

## There remains scope for community councils in Wales to develop and improve financial management and governance, particularly in relation to the quality of their financial reporting, financial management and internal audit arrangements

- 1 There are over 735 town and community councils in Wales. In some cases, these councils jointly provide services through joint committees established for specific services, usually burial services. There are nine such joint committees in Wales. Collectively, this report refers to these bodies as community councils.
- 2 This is my fifth annual report summarising issues identified by external auditors during their statutory audit of community councils in Wales. In my previous reports on financial management and governance at community councils, I set out the changes to the external audit arrangements from 2015-16 onwards. The audit arrangements are intended to help community councils develop their financial management and governance arrangements over time.
- 3 In this first year of the revised audit approach, councils have been subject to a more in depth examination than in previous years. The results reported indicate that many councils may not have grasped the requirements of the new arrangements. Furthermore, the audit focussed on areas where there was already some evidence of gaps in community council's arrangements.
- 4 This is the first report published following these changes to the audit arrangements and it has two main purposes.
- 5 Firstly, the work undertaken by external auditors identifies a number of recurring issues that apply across the community council sector. Furthermore, auditors may identify serious failures on the part of individual councils. **Part 1** of this report draws councils' attention to these issues so that they can consider if the issues apply to them and if there are lessons they can learn from others and use to develop their own arrangements.
- 6 Secondly, my future audit programme is informed by the issues that auditors identify during the audit and wider developments affecting community councils. In my report on the outcomes of the 2012-13 audit, I committed to publishing in advance the specific areas that auditors will focus on in the following year's audit. This will allow community councils to identify areas where they need to develop their arrangements and to take any required action before the start of the financial year. **Part 2** of this report outlines the areas I plan to focus on over the next five years.

- 7 This report summarises the outcomes of audit work completed to 31 October 2016, one month past the statutory deadline for the publication of audited accounts. As at 31 October, 655 out of 740 (88%) audits had been completed.

## **Effective financial management and governance is important because community councils manage significant sums of public money and are becoming more complex bodies**

- 8 Effective financial management and high standards of governance are important for a number of reasons.
- 9 Community councils are entrusted with significant sums of public money. In 2015-16, they raised over £31m from council tax payers, spent over £40m and, as at 31 March 2016, held over £32m in reserves and balances.
- 10 County councils are currently seeking to transfer assets and services to community councils for community councils to meet the service needs of their communities. This will add a degree of complexity to the community council's activities and it is essential that community councils have effective financial management and governance arrangements in place to be able to provide and properly manage these new functions.

## **Community councils are subject to a statutory audit requirement which is designed to be proportionate to the needs of community councils**

- 11 The Auditor General's responsibilities for the audit of community councils are set out in the Public Audit (Wales) Act 2004 (the Act). The Act requires the Auditor General to satisfy himself that:
- a the accounts are prepared in accordance with regulations;
  - b they comply with the requirements of all other statutory provisions applicable to the accounts;
  - c proper practices have been observed in the compilation of the accounts; and
  - d the body has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

- 12 The audit arrangements are, however, designed to be proportionate to the size and scope of councils and to provide a reasonable level of assurance over their stewardship of public money. In practice, this means that auditors' expectations and the extent of work carried out are based on the size and complexity of individual councils.
- 13 This year, the Auditor General changed the way in which the statutory audit of community councils is carried out. The Auditor General's previous reports on financial management and governance in community councils identified a need for a consistent approach to be adopted at all community councils, and this has been applied for 2015-16.
- 14 One of the key advantages of adopting a consistent approach across all councils is that the outcomes from the audit give a full picture of the standards of financial management and governance for the sector. This report draws together auditors' findings from across all community councils in Wales.

### **The audit of community councils' 2015-16 accounts identifies key recurring themes around financial management and reporting that the sector as a whole needs to review and address**

- 15 As in previous years, the number of councils receiving qualified audit opinions is too high. Community councils are subject to a proportionate audit process that tests whether or not the councils comply with their statutory responsibilities. Where a council does not comply the audit opinion is qualified.
- 16 In general, the issues that result in qualified audit opinions are easy to address and councils should already be meeting the standards assessed by the external audit.
- 17 Timeliness and quality of accounts preparation is also a recurring theme as highlighted in the Auditor general's earlier reports on financial management and governance in the sector. Auditors report that councils frequently submit accounts for audit that are late or inaccurate/incomplete.
- 18 Auditors specifically focussed on budget setting and management and how councils engage their internal audit service. Auditors found that practices varied across Wales, although, too many councils fail to meet the required standards. Auditors also identified a number of other recurring weaknesses that councils across Wales can learn from. In some cases, the weaknesses identified were deemed to be sufficiently serious to warrant the Auditor General making formal written recommendations to individual councils.



- 19 Of particular concern is the relative weakness of smaller councils. All councils irrespective of size are required to comply with the same laws and regulations. The audit process is designed to be proportionate to the size of individual councils and expectations are adjusted accordingly. However, a disproportionate number of smaller councils fail to meet the required standards meaning they are not meeting their statutory responsibilities.

**The Auditor general's future audit programme will focus on areas of key weakness identified during the audit cycle**

- 20 The Auditor General's five year programme for community council audit is informed by the outcomes of the 2015-16 and earlier audits. It will also address emerging themes and issues as they are identified.

# Detailed Report



# 1 Community councils in Wales manage significant sums of public money and hold significant values of reserves and assets and this is likely to increase in future

## In 2015-16 community councils received over £43 million of income and incurred over £40 million of expenditure

### Community councils raised over £31 million from council tax and generated over £12 million from other sources in the year to 31 March 2016

- 1.1 Community councils raise funds either through setting a precept, by charging for goods and services, by claiming grants or disposing of long term assets.
- 1.2 A precept is a peremptory order to the unitary authority to pay a named sum to the community council. The amount of the precept is divided between the council tax payers of the community and is paid in full to the community council. In 2015-16, community councils in Wales raised over £32m from council tax payers through their precepts.
- 1.3 Councils also raise funds by charging individual members of the public and other users for goods and services provided by the community council. Charges may typically be made for:
  - a use of village halls/community centres owned and managed by the community council;
  - b burial fees where the community council is a burial authority;
  - c hire charges for sports facilities; and
  - d car parking charges.
- 1.4 Councils may also raise funds for investment in long term assets by applying for grants, drawing down loans or disposing of long term assets. Usually, the use of these funds will be restricted to specific purposes.
- 1.5 In total, in 2015-16, community councils in Wales raised over £12m from these external funding sources.

## Expenditure in 2015-16 totalled over £40 million including over £13 million in staff costs

- 1.6 Community councils have a range of statutory powers and functions upon which they may lawfully incur expenditure. These include powers related to:
  - a appearance of villages including for example, key buildings and sites, good design, and roadside verges;
  - b open air and exercise including for example, village greens, protection of commons, recreational facilities, pleasure grounds and public walks, swimming pools and facilities for countryside visitors;
  - c gatherings including powers related to tourism, entertainments and the arts, halls and centres and twinning;
  - d public lighting and crime prevention including for example surveillance;
  - e ownership and provision of allotments;
  - f health including public conveniences, litter and graffiti and water and pond drainage;
  - g communication including rights of way, works to footpaths and bridleways, shelters and seats and vehicle parks and cycle racks; and
  - h powers related to the dead for example provision of a cemetery.
- 1.7 Community councils employ staff to administer their activities. In many cases, the council employs only one member of staff, the council clerk. However, larger councils may employ several members of staff undertaking activities such as administration or grounds maintenance.
- 1.8 In 2015-16, community councils spent in total over £13 million on staff costs out of total expenditure of over £40 million.

## Community councils in Wales manage reserves worth over £32 million and long term assets worth over £188 million

### Community council reserves at 31 March 2016 exceeded £32 million

- 1.9 Community councils hold reserves and balances for a variety of reasons. These include to finance unforeseen expenditure and to 'save' for future projects. In some cases they are required by law to set money aside for specific purposes. For example receipts from the disposal of long term assets may be defined as capital receipts and only used to finance capital expenditure.
- 1.10 When setting their annual precept, community councils must take into account the level of the reserves they hold and whether or not they plan to finance any of their expenditure from reserves or whether or not they need to increase the amounts set aside in reserves.

### Community councils manage long term assets worth over £188 million as at 31 March 2016

- 1.11 Community councils own various categories of long term assets. These include:
  - a land and buildings – offices, halls, village greens, allotments, cemeteries and parks and sports fields;
  - b outdoor equipment and facilities – playground equipment, bus shelters and seating and public conveniences;
  - c internal fixtures and fittings – IT equipment and furniture; and
  - d civic regalia.
- 1.12 The value of these assets is reported in the councils' annual returns. As unitary authorities transfer assets to community councils, the value of assets held by community councils is likely to increase significantly.

## A significant proportion of the total income, expenditure and assets of the sector is concentrated in the larger councils which are subject to the requirements of the Well-Being of Future Generations Act

- 1.13 Section 40 of the Well-Being of Future Generations Act sets out the role of community councils in relation to local wellbeing plans. It states that councils with annual income or expenditure over £200,000 for three consecutive years or more are subject to duties under the Act.
- 1.14 In 2015-16, 57 (9%) councils had income or expenditure of over £200,000, although, this number fluctuates annually. In 2015-16 these councils;
- a Raised 55% of the total income for the sector;
  - b Incurred 56% of all expenditure incurred by the sector;
  - c Held 45% of all reserves and 55% of all assets (by value) held by the sector.
- 1.15 It is therefore particularly important that these councils ensure their financial management and governance arrangements are fit for purpose.

## 2 Too many community councils in Wales receive avoidable qualified audit opinions and this is particularly the case with smaller councils

### Auditors issue 'qualified' audit opinions when councils fail to comply with their statutory responsibilities

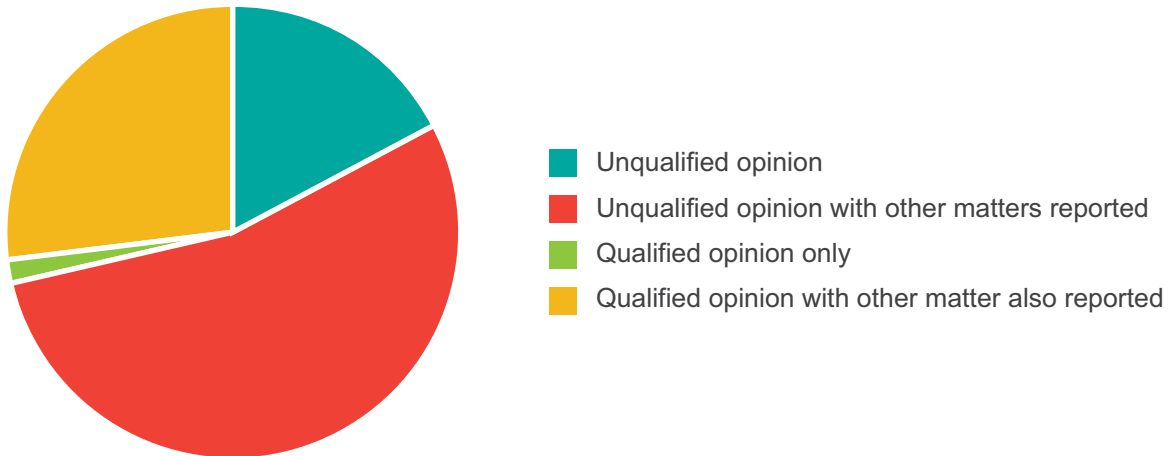
- 2.1 The Auditor General's work is designed to discharge his responsibilities under the Public Audit (Wales) Act 2004.
- 2.2 Auditors review the accounting statements included in the annual return and the assertions made in the Annual Governance Statement to come to a conclusion on whether or not there is evidence that the accounting statements have been properly prepared and whether or not the council has adequate arrangements in place to secure economy, efficiency and effectiveness in its use of resources.
- 2.3 Auditors measure the council's arrangements against its statutory responsibilities and issue a 'qualified' opinion when they identify non-compliance. This means that except for those issues referred to by the auditor, the auditor has not identified evidence to suggest the council does not have proper arrangements in place. However, councils should note that all audit qualifications are avoidable if they have appropriate arrangements in place to comply with their statutory responsibilities.
- 2.4 Auditors will also report on other matters that have come to their attention during the course of the audit. Councils should consider these matters so they can improve their internal arrangements in light of the comments made.

### Over 200 individual councils (30%) received a qualified audit opinion for 2015-16

- 2.5 Thirty% of councils received a qualified audit opinion, 50% received an unqualified opinion but with other matters drawn to their attention, and the remaining 20% received an unqualified opinion with no further matters for their consideration.

### Exhibit 1 – Numbers of councils receiving a qualified audit opinion in 2015-16

Auditors qualified 203 councils' annual returns and raised other matters of concern at 593 councils.



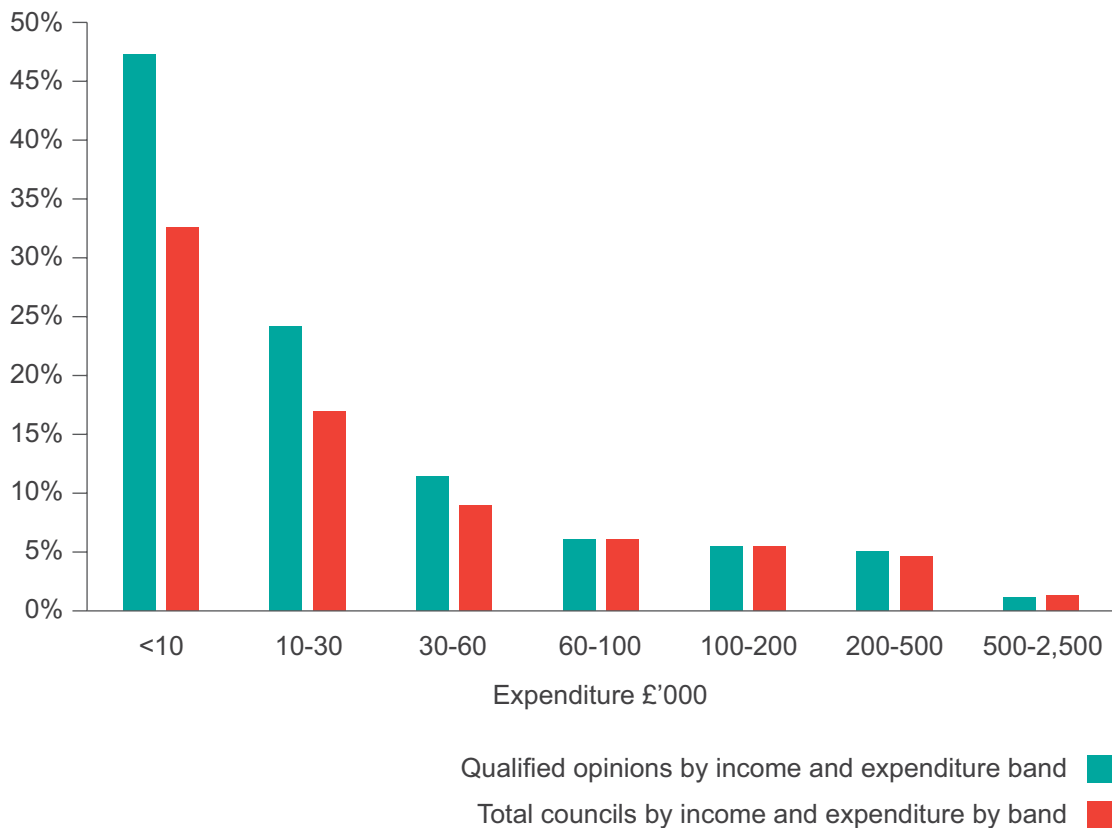
### A disproportionate number of smaller councils receive qualified audit opinions suggesting there is a particular need for these councils to review their arrangements

- 2.6 Auditors issued over 200 qualified audit opinions for 2015-16 on behalf of the Auditor General. In many cases, auditors also drew other matters to the attention of councils. Only 20% of councils received an unqualified opinion with no further matters for their consideration.
- 2.7 All councils regardless of size are required to adhere to the same relevant legislation. Notwithstanding this, the arrangements required for smaller councils do not need to be as complex as those of the larger councils. Auditors take this into account when undertaking their audit work.
- 2.8 Councils with annual income and expenditure below £30,000 each year form about 50% of the total number of councils in Wales. However, they account for over 70% of all councils receiving qualified audit opinions. This means that these councils are more likely to fail in their statutory obligations.



## Exhibit 2 – Numbers of councils with qualified audit opinions by size of council

Councils with annual income and expenditure below £10,000 and from £10,000 to £30,000 represent 33% and 17% of councils respectively. However, 47% and 24% respectively of all qualified councils fall within these bands.



## The most common audit qualifications relate to the failure to adhere to the statutory timetable for the accounts, to put in place arrangements to manage risk, and to set an appropriate budget

- 2.9 Auditors issued qualified opinions for a number of reasons in 2015-16. The most common of these were in relation to assertions made by the councils that they had complied with their responsibilities in relation to:
- approving the accounting statements in accordance with the Accounts and Audit (Wales) Regulations 2014;
  - setting a budget in accordance with the Local Government Finance Act 1992;
  - putting in place arrangements for the management of risk as required by the Accounts and Audit (Wales) Regulations 2014; and
  - keeping proper accounting records and preparing the accounting statements in accordance with the Accounts and Audit (Wales) Regulations 2014.

**Over 8% of councils did not prepare and approve their annual accounting statements in accordance with the timetable set out by the Accounts and Audit (Wales) Regulations 2014**

2.10 Regulation 15 of the Accounts and Audit (Wales) Regulations 2014 sets out the timetable for community councils to prepare and approve the accounting statements. Auditors identified that a significant number of councils did not adhere to this timetable in for the 2015-16 accounts. Further detail is provided in Part 3 of this report.

**Significant numbers of councils failed to set an appropriate budget as required by the Local Government Finance Act 1992**

2.11 Auditors identified as part of a themed review that many councils either do not set a budget or that the budget set does not comply with the specific requirements of the Local Government Finance Act 1992. Further detail and analysis is provided in Part 4 of this report

**Over 45 councils (7%) failed to make proper arrangements for the management of risk**

2.12 Regulation 5 of the Accounts and Audit (Wales) Regulations 2014 sets out the council's responsibility to ensure that there is a sound system of internal control which facilitates the effective exercise of that body's functions, and which includes arrangements for the management of risk.

2.13 This is a recurring issue for the sector and has been identified in each of the Auditor General's reports on community council financial management.

**Auditors were unable to give an opinion (disclaimed to give an opinion) on whether the accounts had been properly prepared at 10 councils**

2.14 Regulation 14 of the Accounts and Audit (Wales) Regulations 2014 requires community councils to prepare accounts in accordance with proper practices. However, auditors of 10 councils were unable to obtain sufficient audit evidence to conclude that the accounts had been properly prepared.

2.15 Examples of the difficulties encountered by auditors leading to this conclusion included:

- a insufficient information to support the value of fixed assets;
- b council unable to explain how individual entries in the accounts, eg, total payments, are calculated leading to unresolved discrepancies;
- c councils unable to provide a properly completed bank reconciliation;

2.16 While this issue affects only a small number of councils each year, it is important that all councils ensure they understand their accounts and ensure that those accounts fairly present the income and expenditure/receipts and payments and balances held at the year end.

### 3 Community councils in Wales need to improve the timeliness with which they prepare their annual accounts and the quality of the annual returns submitted for audit

#### Over 50 councils (8%) failed to comply with the statutory timetable for preparing and approving the accounting statements

The Accounts and Audit (Wales) Regulations 2014 set out a timetable for the preparation and approval of community councils' accounting statements

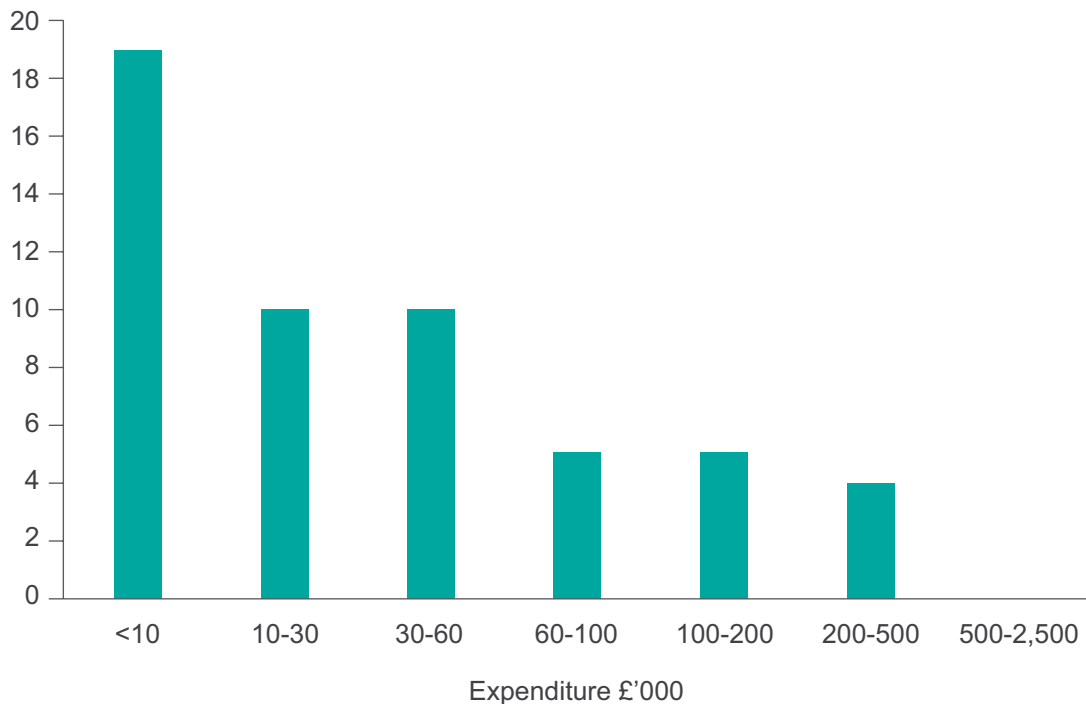
- 3.1 Regulation 15 of the Accounts and Audit (Wales) Regulations 2014 sets out the timetable for the preparation and approval of the annual accounts:
- a The council's responsible finance officer (RFO) must prepare and certify that the accounts properly presents the council's receipts and payment, or present fairly the council's financial position and income and expenditure. The certification is evidenced by the RFO signing and dating the accounting statements. Provision for signature and date are made in the annual return.
  - b The members meeting as a whole must consider the accounting statements and, following that consideration, approve the accounting statements for submission to the auditor by a resolution of the body; and following approval, ensure that the accounting statements are signed and dated by the person presiding at the meeting at which that approval was given;
  - c These actions must be completed by 30 June following the end of the financial year.

#### Over 50 councils failed to adhere to the timetable set out in the Regulations, and most of these were smaller councils

- 3.2 Auditors identified 53 councils where either the RFO or the Council had failed to meet their obligations under the Regulations. Thirty-nine of these councils have annual income and expenditure of less than £60,000.

**Exhibit 3 – Numbers of councils who failed to meet the statutory timetable for preparation of accounts**

Nineteen councils with annual income and expenditure below £10,000, 10 councils with annual income and expenditure between £10,000 to £30,000, and 10 councils with annual income and expenditure between £30,000 and £60,000 failed to meet the statutory timetable for the accounts



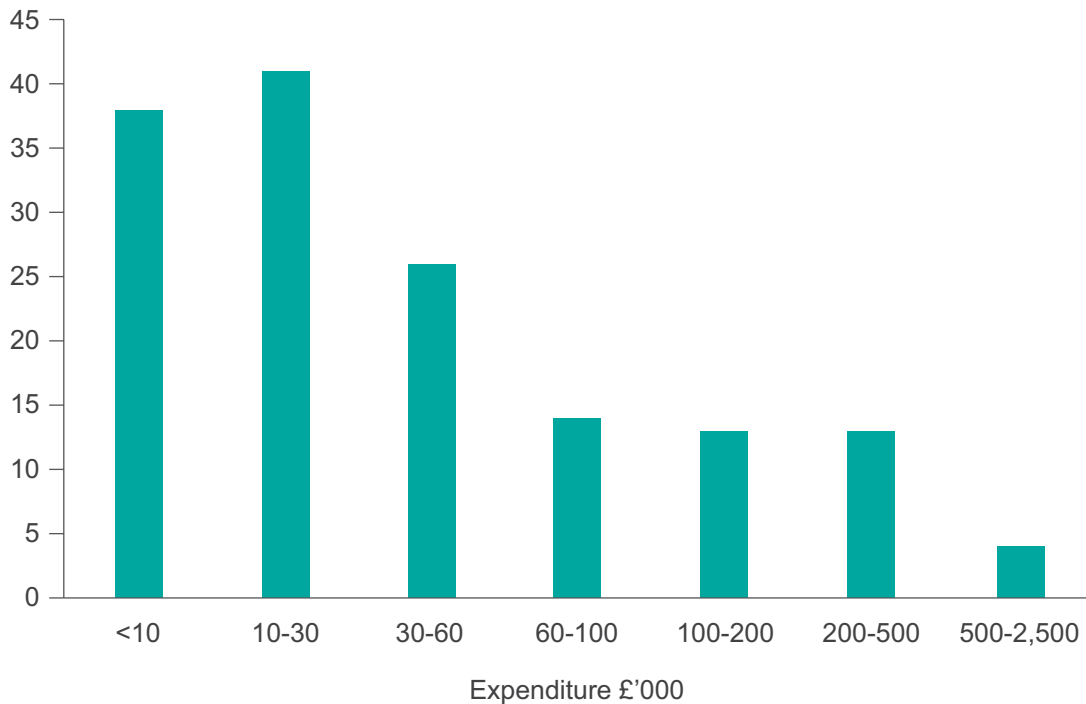
## Too many councils submit annual returns that are incomplete or contain simple errors

### Auditors identified errors in the accounting statements of 149 (23%) councils

- 3.3 The accounting statements required for community councils in Wales are simple, both in structure and accounting requirements.
- a Arithmetic errors. In many cases, the accounting statements did not add up. Often this is as a result of the accounting statements being rounded to the nearest pound. However, it is important that councils ensure that the accounting statements are correctly presented.
  - b Incorrect treatment of unrepresented transactions. At the year end, there will often be timing differences between transactions being recorded in a council's cashbook and the transaction clearing through the council's bank account. As part of their year-end accounts preparation, councils will reconcile the cashbook to the bank statement. Under proper accounting practice, reconciling items are not adjusted for at the year end. Instead they are reversed if necessary in the following year. However, too many councils either amend the prior year accounts or the current year accounts to remove the impact of the uncleared transactions. This has the effect of mis-stating the accounting statements.
  - c Exclusion of bank accounts and transactions. In some cases, poor record keeping by councils means that balances held in some bank accounts and transactions linked to those accounts are excluded from the accounting statements for the year. This results in understatements of the council's balances and mis-statement of its income and expenditure for the year. The lack of internal control also puts at risk the funds held by the council.

#### Exhibit 4 – Numbers of councils with errors in their accounting statements by size of council

The accounting statements of 149 (23%) councils contained avoidable errors due to a misunderstanding of proper accounting practices or lack of attention to detail. This appears to be a particular issue for smaller councils with annual income and expenditure less than £60,000



Source: Wales audit Office analysis of 2015-16 annual returns.

#### 174 councils (27%) submitted annual returns for audit that had not been fully completed

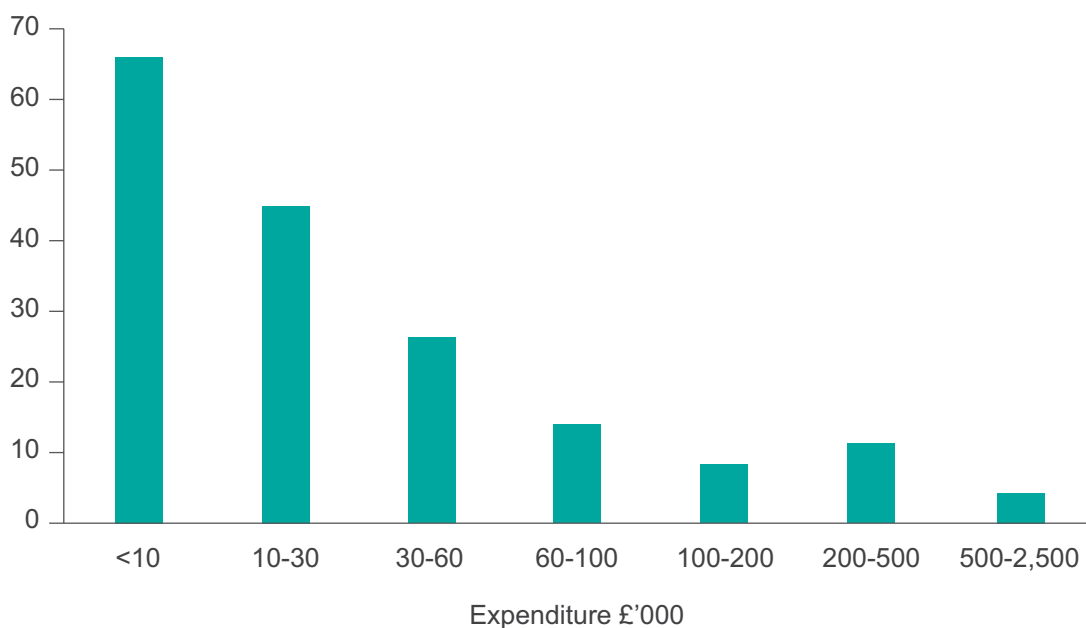
3.4 The annual return prepared by community councils is designed to be easy to complete. Councils are provided with guidance on completing the form on the form itself and also in the Practitioners' Guide. Nevertheless, each year, auditors identify that many councils do not complete the annual return fully. Common issues identified in 2015-16 include:

- a Failure to fully complete the annual governance statement. The Annual Governance Statement is set out in two parts. In the first part, the council makes a number of assertions about its general arrangements. In the second part, the council sets out its arrangements related to the Auditor General’s review of themed governance arrangements. This section is to be completed by all councils and is linked to the changes in the audit arrangements for 2015-16. All councils have previously been informed of the changes to the audit arrangements and given prior notice of the themes to be examined for 2015-16. It is therefore disappointing to note that some councils did not complete this section of the annual return. It is important that every council reads and understands the requirements set out by their auditor and ensures that they fully complete the annual return.
- b Failure to include details required by legislation or the Practitioners Guide. In many cases, councils did not complete the details required. These include failure to insert the minute references to evidence that the council approved the annual return and a failure to include signatures as required by the Accounts and Audit (Wales) Regulations.

3.5 This appears to be a particular issue for smaller councils.

**Exhibit 5 – Numbers of councils with incomplete annual returns by size of council**

Over 170 (27%) councils failed to complete the annual return fully. This appears to be a particular issue for smaller councils with annual income and expenditure less than £60,000



4 The sector as a whole needs to improve its budget setting arrangements if it is to manage additional services and facilities transferred from unitary authorities, and this is particularly the case for smaller councils

### **For the 2015-16 audit, auditors have focused on how councils have set and monitored their budgets**

#### **All community councils are required to set and monitor their annual budget**

- 4.1 The Local Government Finance Act 1992 and proper practices requires councils to calculate and approve the annual budget. Section 41 of this Act allows councils to issue a precept, the basis of which is determined, in accordance with Section 50, by the calculation of the budget requirement.
- 4.2 Regardless of this statutory requirement, the budget is important as
  - a it results in the setting of the precept for the year;
  - b it gives the council authority to spend money in accordance with approved spending plans and financial regulations; and
  - c it provides a basis for monitoring progress during the year by comparing actual to planned spending.
- 4.3 In future, it will also be critical as councils undertake other services and assume responsibilities over other assets as unitary authorities increasingly seek to transfer responsibilities for some services to other bodies such as community councils.
- 4.4 The budget is a crucial element of effective financial management and accountability and ultimately, reduces the amount of time councils spend managing their financial resources. In the absence of adequate budget setting and monitoring arrangements, councils are unable to effectively manage public funds and demonstrate compliance with statutory requirements.
- 4.5 Budget setting was identified as a specific area of focus for the 2015-16 audits. This review identified a number of issues as set out below.

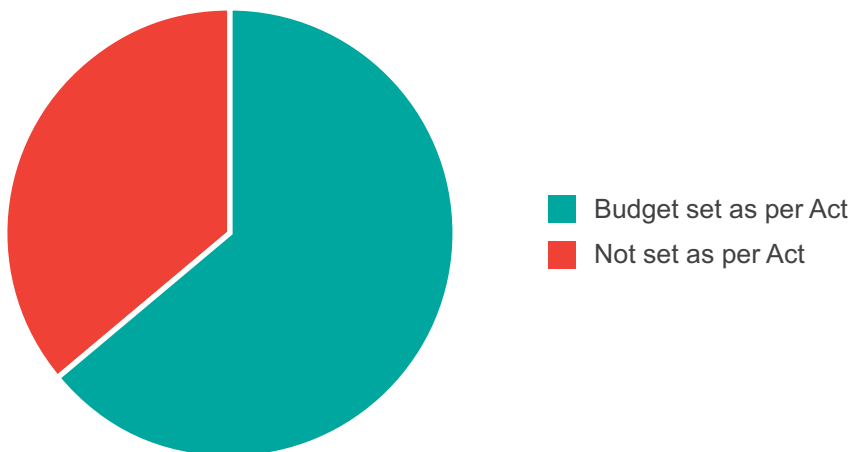


## Over a third (36%) of councils did not set an appropriate budget including all the elements they are required to include by law

4.6 As shown in [Exhibit 6](#), over a third (36%) of councils did not set an appropriate budget. These councils had not taken into account all elements of the budget setting process including planned expenditure, anticipated income, contingencies and reserves, and then approved the final budget.

### Exhibit 6 – Budget setting arrangements

36% of councils did not set a budget as required by the Local Government Finance Act



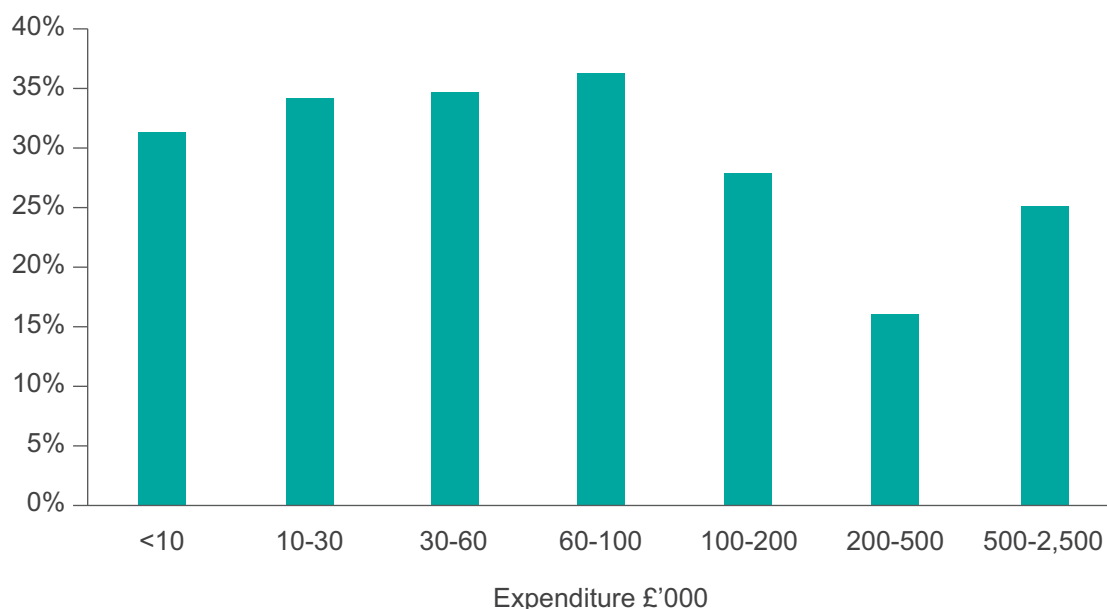
4.7 A more detailed analysis by council size as shown in [Exhibit 7](#) indicates that this is an issue across all bands. Whilst budget setting is important for all sizes of councils, it is particularly important for those 38 councils with annual expenditure over £60,000. It is these councils that will typically seek to take on additional functions from unitary authorities in future. These councils include 10 councils with annual income and expenditure over £200,000 who are subject to duties under the Well-Being of Future Generations Act.

4.8 The most common areas of non-compliance were failures to take into account:

- a Income sources other than the precept. Community councils received over £12 million in other income during 2015-16. This represents almost 30% of the total income for the sector for the year.
- b Reserves and balances. As at 1 April 2016, the sector as a whole held over £30 million in reserves and balances. This represents 96% of the total amount raised from council tax payers for the financial year.

#### Exhibit 7 – Inadequate budget setting by size

Auditors identified that inadequate budget setting is an issue across all sizes of council



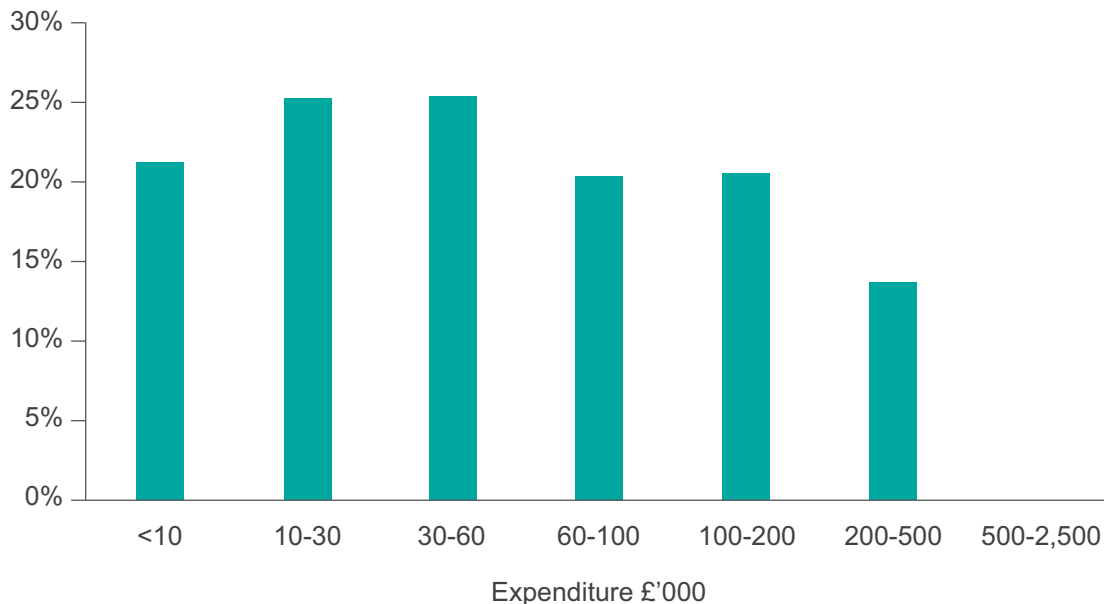
4.9 In some instances, auditors identified that the precept demand to the unitary authority did not agree to the budget requirement set by the council when it set its budget and agreed the precept sum. The councils did not provide evidence to explain why there was a difference between the precept incorporated in the budget and the precept demand issued to the billing authority.

## Over half of all councils do not have adequate budget monitoring arrangements in place

- 4.10 The Accounts and Audit (Wales) Regulations 2014 include a specific requirement for councils to have in place adequate and effective arrangements for financial management. These arrangements include arrangements for monitoring income and expenditure against the budget.
- 4.11 Over half of all councils (52%), including all those that did not set an appropriate budget, had inadequate budget monitoring arrangements in place. Where adequate budget setting arrangements are in place, a quarter (25%) of all councils do not adequately monitor progress against the budget.
- 4.12 After approval of the budget, it should be an active tool for managing the council's finances. Regular comparison of budget to actual outturn should be undertaken allowing consideration, if necessary, of whether expenditure plans should be amended, steps taken to increase income, or whether to utilise reserves. **Exhibit 8** below indicates that the larger size councils with budget setting arrangements in place are better at monitoring those budgets than smaller councils.

### Exhibit 8 – Inadequate budget monitoring by size of council

Over 20% of all councils with annual income and expenditure below £200,000 did not have effective budget monitoring arrangements in place



- 4.13 Over half of all councils (52%), including those that did not set an appropriate budget, had inadequate budget monitoring arrangements in place. Where adequate budget setting arrangements are in place, a quarter (25%) of those councils do not adequately monitor progress against the budget.

5 Many community councils will find it difficult to demonstrate that they have an adequate and effective system of internal audit in place, and receive full value from that service

### For the 2015-16 audit, auditors focused on the terms of reference for internal audit

All community councils are required to have in place an adequate and effective internal audit

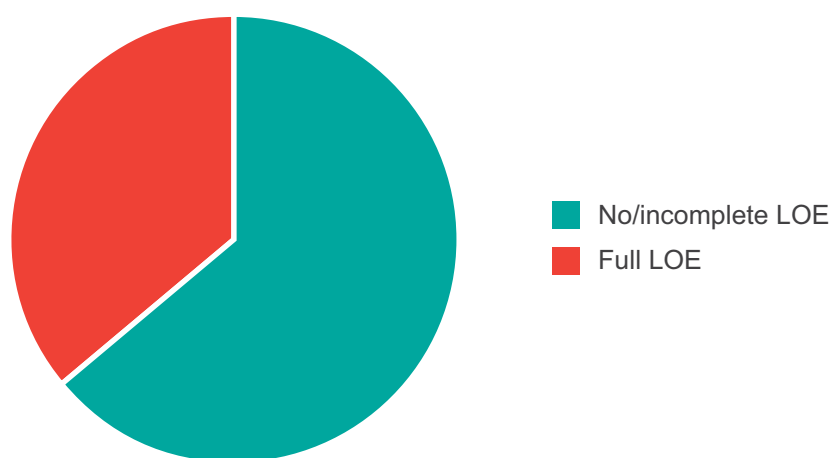
- 5.1 The Accounts and Audit (Wales) Regulations (Regulation 6) require all community councils in Wales to have an adequate and effective system of internal audit in place. Internal audit forms an important part of the internal control arrangements that each council is required to have and review annually.
- 5.2 The responsibility for determining whether or not internal audit is adequate and effective lies with individual councils. In order to make this assessment, councils must consider the audit needs, taking into account the size and complexity of the individual council, and also how the internal auditor discharges the audit function ie, the quality of the audit work undertaken.
- 5.3 The 2015-16 external audit examined whether or not councils had agreed terms of reference with their internal auditor. Such terms should be set out in a letter of engagement with the internal auditor. It should set the expectations of both parties regarding issues such as:
  - a respective roles and responsibilities;
  - b planning, scope and timing of audit work;
  - c reporting requirements;
  - d independence and competence assurances; and
  - e access to information and relevant personnel.
- 5.4 In the absence of a comprehensive and complete terms of reference, councils cannot clearly assess whether the internal auditor has met their expectations and complied with the Accounts and Audit (Wales) Regulations.

## A majority of councils did not have full terms of reference in place for their internal audit

5.5 **Exhibit 9** shows that almost two out of three councils (64%) had no or inadequate internal audit terms of reference.

### Exhibit 9 – Inadequate internal audit terms of reference

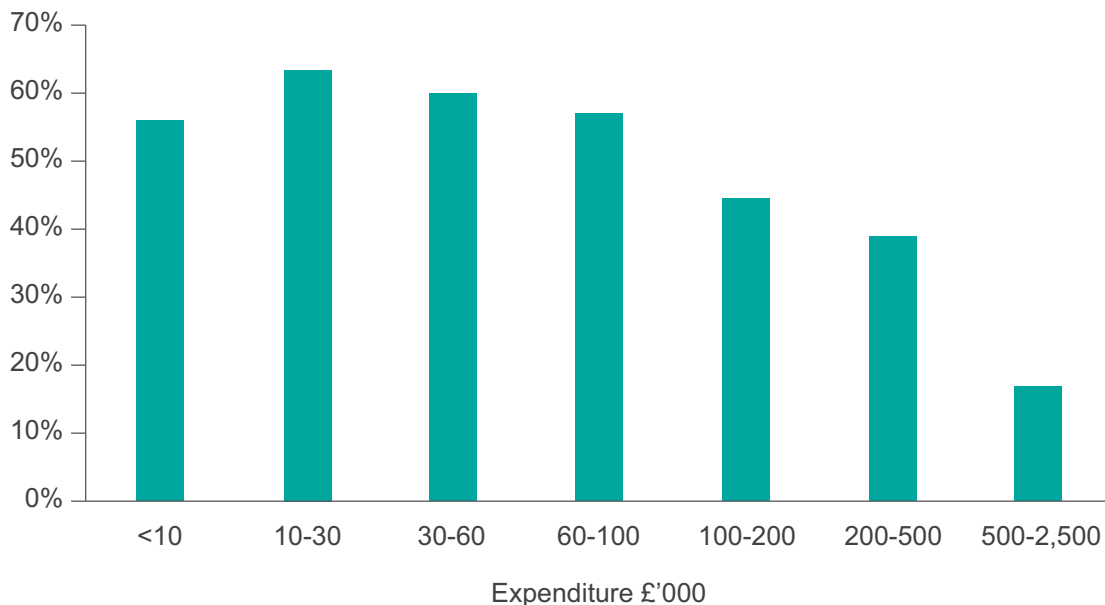
64% of councils did not have adequate terms of reference for their internal auditor



5.6 As shown in **Exhibit 10**, this issue is prevalent across all sizes of council, although, less so in the larger councils.

### Exhibit 10 – Councils with no or inadequate terms of reference as percentage of councils in size band

The percentage of councils without full or any terms of reference ranges from 17% to 63% of councils by band

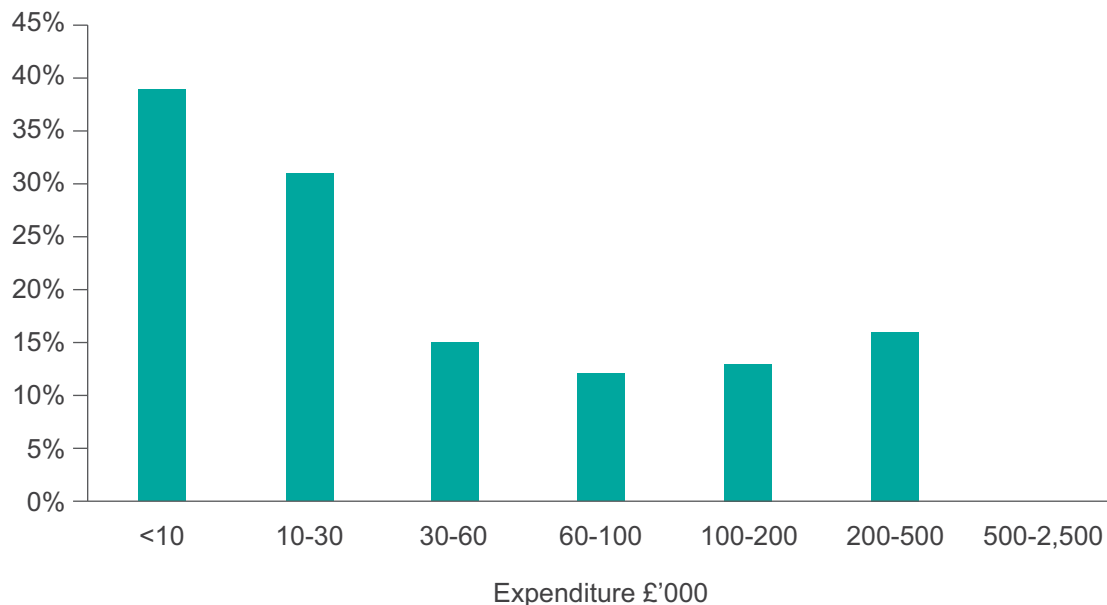


### Almost a third of community councils also lack any detailed feedback from their internal auditor meaning they do not receive the full value from the internal audit service

- 5.7 Our audit work also highlighted deficiencies in the internal audit reporting arrangements at approximately two fifths of all councils. This means that not all tests in the annual internal audit report included on the reverse of the annual return had completed or where neither an outline of internal audit work undertaken nor a separate detailed report had been provided.
- 5.8 Where councils do not receive and consider adequate reports, councils do not receive full value from the internal audit service.
- 5.9 In addition, some one third of all councils (32%) had both inadequate internal audit terms of reference and reporting arrangements. These two issues are likely to be related: deficiencies in reporting arrangements may often arise from deficiencies in the terms of reference between the two parties. Again, as shown in [Exhibit 11](#), this is more common in the smaller councils where internal audit arrangements may be more informal.

### Exhibit 11 – Councils with both inadequate internal audit terms of reference and reporting arrangements by size of council

Between 10% and 40% of councils lack both adequate terms of reference with, and effective reporting arrangements by, their internal auditor. This is particularly the case for councils with annual income and expenditure below £30,000



5.10 Adequate internal audit terms of reference would help both councils and internal auditors understand their respective responsibilities and consequently to address deficiencies, including those regarding reporting arrangements, arising. Those councils with both inadequate terms of reference and reporting arrangements will find it difficult to evidence that they have maintained an adequate and effective system of internal audit in accordance with statutory requirements.

### In some cases, internal audit drew different conclusions to those of the external auditor suggesting that the work undertaken by internal audit was insufficient

5.11 In section 4 of this report, I noted that significant numbers of community councils did not set an appropriate budget and/or did not have effective budget monitoring in place. I also noted that in some cases, the precept demand sent to the council tax billing authority differs from the sum approved by the council.

5.12 In the majority of these cases, the internal auditor in a report to the council asserts that 'the annual precept demand requirement resulted from an adequate budgetary process, progress against the budget was monitored and reserves were appropriate'.

5.13 It is a matter of some concern that the reported results of internal audit's work are not supported by the findings of the external auditor.



## 6 Auditors reported on a number of recurring matters that councils across Wales could learn from

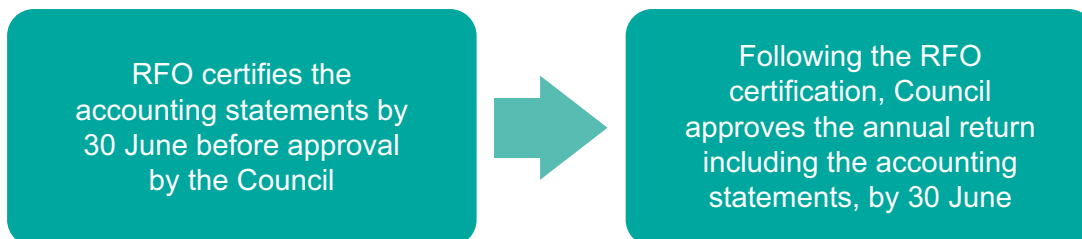
### Many councils do not follow the basic procedural requirements set out in law

#### Many councils fail to follow the correct procedural requirements when approving the Annual Return

- 6.1 The Accounts and Audit (Wales) Regulations 2014 set out the process that community councils must follow when approving the Annual Return. This process is set out below.
- 6.2 Auditors noted that over 30 councils (5%) did not properly follow these arrangements.

#### Exhibit 12 – The statutory approval process for community council’s accounts

The responsible Financial Officer must certify the accounting statements before the Council approves the accounting statements, and the annual governance statement



- 6.3 Auditors identified cases where:
- a The RFO only certified the accounting statements after the Council had approved the annual return.
  - b Either or both the RFO or the Council had failed to discharge their responsibilities by 30 June. In some cases, this was due to individual councils' meeting cycles and could have been addressed by the council altering, for one month, their normal meeting schedule.

### **Auditors reported that a number of councils do not prepare minutes in accordance with the requirements of the Local Government Act 1972**

- 6.4 The Local Government Act 1972 requires that each council must keep minutes of the proceedings of the council and its committees. The minutes held by the council represent the lawful record of its discussions and decisions. Where loose leaf minutes are kept rather than a minute book, each page must be consecutively numbered and initialled by the person signing the minutes at the time of signature.
- 6.5 Auditors reported that loose leaf minutes provided by councils as audit evidence are not initialled as evidence that they are authentic. Where minutes are not properly kept, there is a risk that minutes could be replaced by inaccurate or misleading records. Furthermore, there is also the risk that councils are unable to properly evidence the decisions taken by the council and how those decisions have been arrived at.

### **Auditors noted recurring issues related to councils' potential non-compliance with the law that could have a financial impact on individual councils**

#### **Auditors reported that several councils currently maintain gratuity funds for the benefit of officers of the councils**

- 6.6 Community councils have in the past given gratuity payments to clerks on retirement. However, these payments were in the gift of the employer and could only be awarded at the point of the employee's departure. The statutory basis for such payments was set out in the Local Government (Discretionary Payments) Regulations 1996.
- 6.7 The Discretionary Payments Regulations were amended at various times until their eventual repeal in January 2012. Therefore, at present, there is no statutory basis for making a gratuity payment.
- 6.8 Notwithstanding this, auditors have reported that a number of councils currently maintain gratuity funds and may hold such funds in separate bank accounts.
- 6.9 Councils are advised that before they make any gratuity payments, they should obtain proper legal advice to minimise any risk of making an unlawful payment.

### Community councils inappropriately making use of the 'free resource' available under section 137 of the Local Government Act 1972

- 6.10 Community councils are statutory corporations and only have such powers that are conferred on them by statute. This means that they must be able to identify a specific statutory power for each of their actions. Notwithstanding this, subject to some formalities, section 137 of the Local Government Act 1972 gives community councils a general power to spend up to a certain limit in each financial year for any purpose which, in its opinion, is in the interests of or will directly benefit the area or its inhabitants. However, where the council has a specific statutory power, the specific power should be applied rather than section 137.
- 6.11 Auditors noted that councils regularly make payments relying on section 137 when a more appropriate, specific power is available.

### Auditors reported that a number of community councils appear to be making inappropriate reclaims of VAT on behalf of other bodies

- 6.12 In his report in the public interest for Mawr Community Council dated December 2011, the appointed auditor drew attention to inappropriate arrangements made by the council to reclaim VAT on behalf of bodies ineligible to make such claims.
- 6.13 During the 2015-16 audit, auditors identified a number of arrangements whereby councils are seeking to recover VAT on behalf of others. It is our view that such arrangements are likely to be unlawful. Councils should therefore seek advice from HM Revenue and Customs to ensure that the arrangements they put in place comply with tax legislation. A failure to do so would place the council at risk of significant financial penalties.

## Some councils hold significant levels of financial reserves without a clear purpose as to why those reserves are held

Although reserves held by individual councils vary, in total, at 31 March 2016 community councils in Wales held balances that exceeded the annual 2015-16 precept raised from council tax payers

- 6.14 As at 31 March 2015, community councils in Wales held reserves totalling over £30.1 million.
- 6.15 Collectively, community councils raised £31.4 million from council tax payers in 2015-16 and increased the sums held in reserves to over £32.4 million at 31 March 2016. This year-end balance exceeds the sum raised from council tax payers during the year.

Auditors identified that councils commonly fail to take their reserves into account when setting their annual budget and precept

- 6.16 Community councils have no general power to hold large sums as financial reserves. In some cases, councils must set aside certain funds as reserves. These include capital receipts which are not available to support the council's day to day costs.
- 6.17 The Local Government Finance Act 1992 specifically requires community councils to take reserves into account when setting their precept. Auditors examined the budgets set by councils and noted that one of the most common failings was that individual councils took no account of the sums held in reserves.
- 6.18 At individual councils, reserves held range from 3% of the precept for 2015-16 to 3,300% of the precept. In many cases, councils were unable to provide explanations as to the purpose for which the reserves are held.

## In many cases, councils need to make significant improvements to the records of the long term assets they hold

### Community councils in Wales hold in excess of £188 million of assets

6.19 Community councils hold a wide range of long term assets including land and buildings, playground equipment, public conveniences, furniture and fittings, and civic regalia. The value of these assets is reported in the annual accounting statements as over £188 million across Wales.

### Auditors identified that councils commonly have no or only limited records of the assets they hold

6.20 All councils, regardless of their size and the extent of the long term assets held, should have a full record of these assets. Such records should be sufficient to identify the cost or value of individual assets and details of where title deeds etc may be found.

6.21 Auditors have frequently found that councils have limited or no records of the long term assets they hold. As they take on assets and services from unitary authorities, it will become even more important for community councils to maintain proper asset records.

## 7 Since the publication of the Auditor General's report on the 2014-15 accounts, auditors have exercised statutory powers to make formal recommendations to a small number of councils

- 7.1 As part of the audit, the Auditor General has a duty under the Public Audit (Wales) Act to consider whether, in the public interest, he should make a report on any matter which comes to his notice in the course of the audit, in order for it to be considered by the body, or brought to the attention of the public. The Auditor General also has a statutory power to issue written recommendations to councils and require the councils to consider those recommendations in accordance with specific provisions within the Act. Where the Auditor General exercises these powers, councils must consider the recommendations at a public meeting and publish their response to the report or recommendations.
- 7.2 When auditors exercise these powers, there are usually lessons that can be applied to other councils across Wales. The Auditor General recommends that all councils consider the following issues and whether any of the issues raised may apply to them.

### Auditors made written recommendations to improve councils' financial management and compliance with statutory requirements

#### Holyhead Town Council

- 7.3 In April 2016, the auditor issued a report to Holyhead Town Council, setting out deficiencies in its delegation arrangements, its budget setting, and its internal financial rules. The auditor found that:
- a The Council had improperly delegated responsibility for consideration of planning matters to individual councillors. Such arrangements are contrary to law which prohibits the council delegating its functions to individual members.
  - b The council operates a cinema complex, but excluded from its budget the income and expenditure generated by the cinema.
  - c In addition, the accounting arrangements for the cinema did not support effective financial management and decision making.
  - d The council's standing orders which govern the way in which it operates were significantly out of date and no longer reflected the way in which the council operated.

## Machynlleth Town Council

- 7.4 In April 2016, the auditor issued a report to Machynlleth Town Council, setting out deficiencies in its financial management and governance spanning the six financial years up to and including 2014-15. The auditor found that during this period:
- a The Council failed to maintain adequate and complete financial records;
  - b The Council failed to prepare its annual accounts on a timely basis;
  - c The Council failed to prepare its accounts on the correct basis due partly to the lack of records, and partly due to incorrect treatment of significant income and expenditure related to its 'Y Plas' facility.
  - d The Council commissioned an external consultant to assist the council to address its problems with the accounts and to undertake internal audit work. However, the identified deficiencies with the work undertaken includes:
    - the accounts prepared by the consultant did not agree with the underlying records;
    - the bank reconciliation prepared did not reconcile the cashbook and the bank accounts; and
    - the accounts were not prepared on the correct accounting basis.
- 7.5 As a consequence of the Council's failure to maintain proper records, the Council has incurred a loss of over £5,000 in VAT that it is no longer able to recover.

## Nantyglo and Blaina Town Council

- 7.6 In December 2016, the auditor issued a report to Nantyglo and Blaina Town Council, setting out deficiencies identified as part of the audit of the 2014-15 accounts. The auditor found that:
- a the council had not maintained records of contracts of employment for its employees; and
  - b although reporting that contracts of employment had been examined in the year, the council's internal auditor was unable to provide evidence that this internal audit work had actually been completed.

## 8 The Auditor General's audit programme for 2016-17 to 2020-21 will continue to focus on areas where there is scope for community councils to improve their financial management and governance

**For the 2016-17 audit, auditors will focus on the arrangements councils have made to adopt a Code of Conduct for members, and to ensure they are properly dealing with payroll issues**

**All community councils must adopt a Code of Conduct for Members and individual members agree to abide by the Code**

- 8.1 An essential part of any body's governance framework is the behaviour demonstrated by the members of that body. The Local Government Act 2000 created a new ethical framework for local government in Wales. It created a power for the Welsh Ministers to issue a model code of conduct to apply to members and co-opted members of all relevant authorities in Wales.
- 8.2 Community councils are required to adopt the Code in its model form in its entirety, but can make additions to the Code, provided these are consistent with the Model. The locally adopted Code is then integral to the individual council's governance framework.
- 8.3 For the 2016-17 audit, auditors will consider how the Code has been adopted and will seek evidence that:
  - a the council has adopted a Code of Conduct;
  - b individual members has agreed (on acceptance of office) to abide by the Code; and
  - c the council is maintaining a register of members' interests.

**Community councils employ staff and unless they are exempt from doing so must ensure that they register with HM Revenue and Customs as an employer**

- 8.4 Organisations normally need to register as an employer with HM Revenue and Customs (HMRC) when they start employing staff. Community councils usually have only one paid officer, the Clerk. The majority of these Clerks work part-time, their hours varying from one to two days per week, to a few hours per quarter in connection with Council meetings.



- 8.5 However, the Clerk is an office holder and emoluments received, whether described as an honorarium, a salary, a payment towards expenses or a combination of these, are chargeable as employment income and there is liability for Class 1 National Insurance Contributions (NICs)
- 8.6 As employers, community councils normally have to operate PAYE as part of their payroll. PAYE is the HMRC system to collect income tax and national insurance from employment. There are however exemptions from this requirement. For example, employers do not need to register for PAYE if no employees are paid £112 or more a week, get expenses and benefits, have another job, or get a pension. However, all employers must keep payroll records
- 8.7 For the 2016-17 audit, auditors will seek evidence that:
- a The council has registered with HMRC and is operating PAYE as required. This evidence may be in the form of returns to HMRC or confirmations from external payroll providers.
  - b Where councils are not registered, confirmation of the reasons why the council has not registered.
  - c The council is keeping proper payroll records.

## **For the 2017-18 audit, auditors will focus on the effectiveness of internal audit and how councils manage their reserves and balances**

**An effective internal audit function is an essential part of any council's system of internal control, and the 2017-18 audit will focus on the adequacy of work undertaken**

- 8.8 Internal audit forms an important part of the internal control arrangements that each council is required to have in place and review annually.
- 8.9 The 2015-16 external audit examined whether or not councils had agreed terms of reference with their internal auditor. Section 5 of this report sets out the Auditor General's findings in relation to internal audit and identifies concerns over how councils can assess the adequacy and effectiveness of its internal audit function. This report also draws attention to inconsistencies between internal auditors' findings and those of the external auditor.
- 8.10 Therefore, for the 2017-18 audit, auditors will examine the work undertaken by internal audit in order to assess whether or not it meets the expectations of the sector.

**Community councils in Wales hold in excess of £32 million in reserves and balances, and the 2017-18 audit will examine how councils plan to use these reserves for the public benefit**

8.11 Community councils hold in excess of £32m in reserves and balances. In some cases these reserves will include capital receipts which have restricted uses. However, audit work in 2015-16 identified that many councils do not take their reserves into account when setting their annual precept.

8.12 The 2017-18 audit will therefore consider what plans community councils have for their reserves and balances and how they manage these resources effectively.

**Looking forward to 2018-19 and beyond, the Auditor General's programme will continue to look at common issues arising during the annual audit, and will also incorporate a review of the sector's response to the Well-Being of Future Generations Act 2015**

**Each year, the Auditor General identifies a number of common or recurring issues as part of the annual audit work, and these will be considered as part of the future audit programme**

8.13 As reported above, auditors continue to identify recurring issues as part of their normal audit work. The Auditor General will incorporate themed governance reviews of these issues as part of his annual audit programme.

8.14 The issues identified for review will be those that are commonly identified, or those that have a significant potential impact on community councils and their effective use of public funds.

**For community councils, the Auditor General will discharge his responsibilities under the Well-Being of Future Generations Act 2015 in a proportionate manner by integrating his work within the statutory audit process**

8.15 Community councils in Wales with gross income or expenditure over £200,000 each year have a duty under the Well-Being of Future Generations Act 2015 to take all reasonable steps towards meeting the objectives included in the wellbeing plan in effect in its area. Each financial year, relevant councils must publish a report on the progress it has made in meeting the local objectives.

8.16 The Auditor general also has responsibilities under the Act to carry out an examination of each public body at least once every five years. The Auditor General's approach will be proportionate to the scale of the sector, and details have yet to be worked out. We do, however, propose that an initial examination will take place during 2020-21.

**The Auditor General's future programme of themed governance reviews is set out in a four year plan, although, this may be subject to change as issues emerge over time**

8.17 The objective of the new audit arrangements introduced for 2015-16 is to examine and assess the effectiveness of community councils' governance arrangements over a period of years. The reviews will focus on recurring themes identified as part of the annual audit cycle and will help councils to improve their arrangements where required over time. **Exhibit 13** sets out my current proposed timetable for future governance themes, although, these may change over time.

**Exhibit 13 – Future governance themes**

The Auditor General's future governance themes for community councils will broadly follow a four year plan, although, this may be subject to change as issues emerge

2017-18	2018-19	2019-20	2020-21
Effectiveness of Internal Audit Use of reserves	Compliance with Standing Orders Delegation to committees	Use of s137 Local Government Act 1972 Arrangements for making payments	Employment of staff Well-Being of Future generations

Wales Audit Office

24 Cathedral Road

Cardiff CF11 9LJ

Tel: 029 2032 0500

Fax: 029 2032 0600

Textphone: 029 2032 0660

We welcome telephone calls  
in Welsh and English.

E-mail: [info@audit.wales](mailto:info@audit.wales)

Website: [www.audit.wales](http://www.audit.wales)

Swyddfa Archwilio Cymru

24 Heol y Gadeirlan

Caerdydd CF11 9LJ

Ffôn: 029 2032 0500

Ffacs: 029 2032 0600

Ffôn Testun: 029 2032 0660

Rydym yn croesawu galwadau  
ffôn yn Gymraeg a Saesneg.

E-bost: [post@archwilio.cymru](mailto:post@archwilio.cymru)

Gwefan: [www.archwilio.cymru](http://www.archwilio.cymru)