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Archwilydd Cyffredinol Cymru
Auditor General for Wales

Financial Management and Governance in Local Councils 2014-15



WALES AUDIT OFFICE
SWYDDFA ARCHWILIO CYMRU



Since 2011-12 local councils in Wales have improved their financial management and governance, preparing the accounts more promptly: but the number of qualified audit opinions has increased and there are still too many failures in financial governance.

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Summary report

Introduction

- 1 All public bodies in Wales, including town and community councils (local councils), have a responsibility to the citizens of Wales to account for their stewardship of the public money they have been entrusted with. The principal means of doing this is by the preparation of annual accounts that are subject to an independent external audit.

The audit arrangements for local councils are designed to be proportionate to the size and scope of councils, and provide a reasonable level of assurance over their stewardship of public money

- 2 Local councils with an annual turnover of up to £2.5 million are subject to a limited assurance audit framework. The framework does not require a full audit in accordance with professional auditing standards. Instead, it provides a level of assurance proportionate to the amounts of public money managed by these small bodies.
- 3 Local councils are required to submit a minimum amount of information to the auditor with a completed annual return. Auditors consider the body's overall control environment and obtain additional evidence to support their opinion to reflect the greater risk associated with higher levels of activity or expenditure. Additional work is undertaken where required to address specific issues identified during the audit. Further details of the financial accountability framework for local councils are set out in [Appendix 1](#).
- 4 From 2015-16 onwards the audit will focus on specific themes each year designed to promote and facilitate improved financial management and governance.

The Local Government (Wales) Bill proposes an important role for auditors' opinions as a qualifying condition for local councils being able to exercise a general power of competence

- 5 In November 2015, the Welsh Government consulted on a new Local Government (Wales) Bill which incorporates proposals to provide town and community councils in Wales with a general power of competence. The general power of competence gives a qualifying council the same power to act that an individual generally has. It is a power of first resort which means that a qualifying council does not need to rely on specific powers in legislation to do something, so long as what they intend to do is not otherwise illegal.
- 6 The bill also proposes three requirements a community council must meet, and the procedure it must follow, in order to be able to exercise the general power of competence. The bill proposes that a council must pass a resolution that it meets all of the competency requirements and that it is a community council with competence.
- 7 These requirements include an audit condition. To meet the audit condition the council must have received two unqualified auditors' opinions for two consecutive financial years, the latest of which must have been received during the 12 months ending on the day on which a council resolves that it meets all of the competency requirements.

Auditors' work across Wales indicates that councils have made progress to improve their financial management and governance but demonstrates that more work still needs to be done

- 8 Previous reports¹ from the Auditor General drew attention to the most common issues identified by auditors across Wales. This report considers the progress made by local councils to address these weaknesses and highlights areas the Auditor General will focus on for the audit of the 2016-17 accounts.
- 9 This report summarises the outcomes of the Auditor General's appointed auditors' work on the 2014-15 accounts of town and community councils and their joint committees across Wales. It identifies that auditors are reporting on similar themes for 2014-15 as were reported on in previous years, indicating that the sector still needs to improve in several key areas if councils are to meet the proposed competency requirements.

¹ Improving Financial Management and Governance: Issues from the Audit of Community Council Accounts 2011-12, Financial Management and Governance in Local Councils 2012-13 and Financial Management and Governance in Local Councils 2013-14

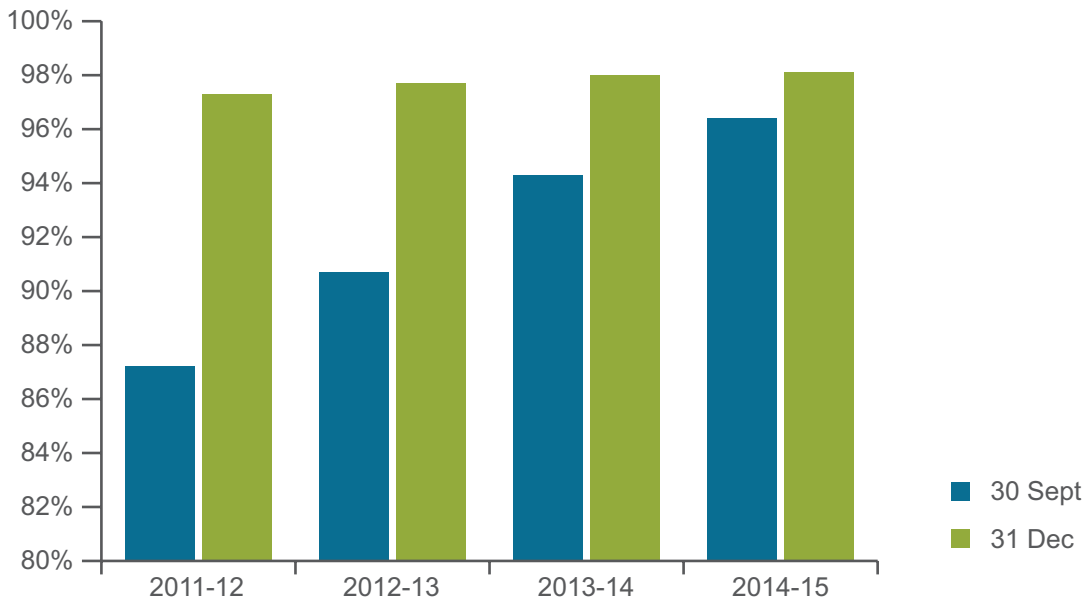
Part 1

Ninety-six per cent of all councils now achieve the statutory reporting deadline of 30 September



- 1.1 In order to minimise both the cost and time required to undertake the audit for councils, it is important that councils provide the auditor with required information that is timely, complete and accurate.
- 1.2 The Welsh Government encourages greater transparency by public bodies to explain how they use public money. Local electors are entitled to see how their local council has spent the money it has collected from fees and charges or via the annual precept, from council tax. Councils that fail to publish an annual return on a timely basis are not providing this basic level of public accountability. **Exhibit 1** identifies the progress made by Welsh councils since 2011-12.

Exhibit 1 - Completion of audit work on accounts between 2011-12 and 2014-15



- 1.3 Auditors aim to complete their audit work and issue their certificate and opinion in sufficient time to allow local councils to publish their annual return with an audit opinion by 30 September as required by the Accounts and Audit (Wales) Regulations.
- 1.4 By 30 September 2015, auditors had issued the opinion and certificate on the 2014-15 annual return at 96 per cent of councils compared with 94 per cent for 2013-14. This continues the steady progress made by the sector.

1.5 By 31 December 2015, the number of completed audits had increased to 98 per cent; this is comparable with the 2012-13 and 2013-14 accounts. However, this still meant that there were 14 (two per cent) of councils that had not received an audit opinion three months after the deadline. **Exhibit 2** sets out the reasons for the delayed completion of the audit. Each of these audits remained outstanding as at 31 January 2016.

Exhibit 2 - Councils with incomplete audits at 31 December 2015

Council	Explanation
Abertillery and Llanhilleth Town Council	Ongoing audit work.
Bodorgan Community Council	Ongoing audit work.
Bontnewydd Community Council	Council has not yet submitted its annual return for 2015.
Bryneglwys Community Council	The Council submitted the annual return for audit in January 2016. This is a recurring issue for this council.
Builth Wells Town Council	Ongoing work in relation to an elector's question.
Cynwyd Community Council	Council has not yet submitted its annual return for 2015. Late submission of accounts is a recurring issue for this council.
Llanedi Community Council	Ongoing work in relation to an elector's question.
Llangristiolus Community Council	Ongoing audit work.
Machynlleth Town Council	Audits incomplete from 2009-10 onwards. Audit work is ongoing.
Nantyglo and Blaina Community Council	Ongoing audit work.
Pistyll Community Council	Council has not yet submitted its annual return for 2015.
St Asaph Community Council	Council delayed response to auditor's request for information.
St Donats Community Council	Council did not advertise the audit as required by the Accounts and Audit (Wales) Regulations 2014.
Wentlooge Community Council	Council has not yet submitted its annual return for 2015.

Part 2

Too many councils receive qualified audit opinions each year and many have done so for two or more of the last four years

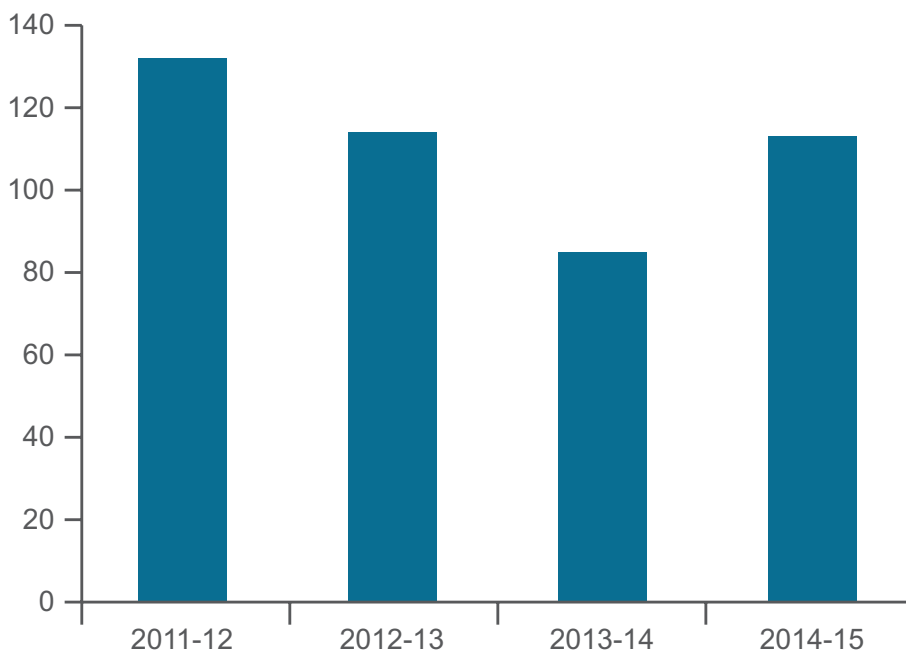


- 2.1 Auditors qualify their opinion on the annual return because of issues identified in the accounting statements and/or the Annual Governance Statement (AGS). A qualification on the AGS may relate to one or more of the assertions made by the council.
- 2.2 It should be noted that all audit opinion qualifications are avoidable if individual councils have adequate and effective financial management and governance arrangements in place, and follow the simple steps required to prepare annual accounts and submit them for audit.

The number of councils with qualified audit opinions has increased for 2014-15 reversing the trend of the previous three years

- 2.3 The number of councils with audit opinions qualified in each of the last four financial years is shown in **Exhibit 3**. Auditors issued qualified audit opinions on 113 (15 per cent) of the 2014-15 annual returns; this represents a small increase from 2013-14 (85 councils, 12 per cent).

Exhibit 3 - Number of qualified audit opinions 2011-12 to 2014-15



2.4 It remains the case that almost one in seven councils in Wales fail to meet the minimum required standards of governance.

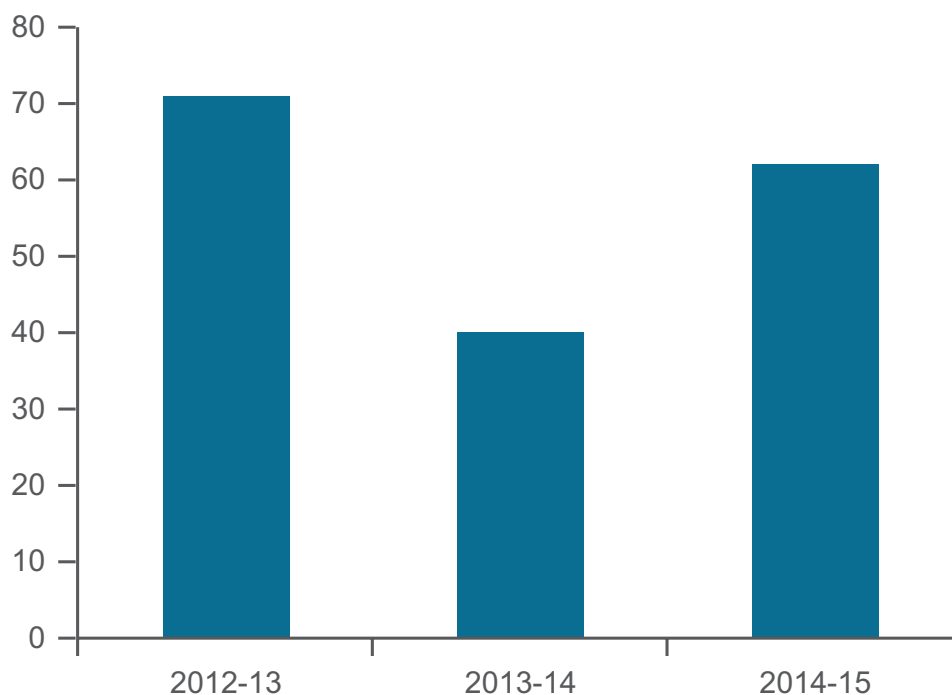
Over 40 per cent of Welsh town and community councils have received one or more qualified audit opinions since 2011-12, and each year between five and 10 per cent of all councils receive a qualified audit opinion for the first time

2.5 Between 2011-12 and 2014-15, auditors have qualified their audit opinions for one or more financial years at 305 councils; this represents 41 per cent of all town and community councils in Wales. These councils would fail to meet the audit condition proposed in the Local Government (Wales) Bill.

2.6 Of particular concern are the numbers of councils that receive a qualified opinion that have not previously received a qualification on their annual return. Sixty-two of the 113 councils qualified in 2014-15 had not received a qualified audit opinion between 2011-12 and 2013-14.

2.7 **Exhibit 4** shows the number of councils with qualified audit opinions in 2012-13, 2013-14 and 2014-15 that had not received a qualified opinion in previous years. This highlights that each year between 40 and 70 councils receive qualified audit opinions for the first time since 2011-12.

Exhibit 4 - Number of councils qualified each year with no previous qualifications since 2011-12



An unacceptably high number of councils have received qualified audit opinions for two or more of the last four financial years

- 2.8 Ninety-five councils in Wales (13 per cent) received qualified audit opinions for two or more of the last four years.
- 2.9 Of particular note are the 34 councils (four per cent) listed in [Exhibits 5 and 6](#) whose annual returns have been qualified for three or more of the last four financial years.
- 2.10 The repeated qualification of the audit opinion at these councils suggests there are systemic weaknesses in their financial management and governance arrangements, or a lack of commitment or ability to get things right.

Exhibit 5 - Councils with qualified audit opinions for each of the last four financial years

Council
Capel Curig Community Council
Dinas Cross Community Council
Faenor Community Council
Henryd Community Council
Llanfarian Community Council (MWW)
Llanpumsaint Community Council
Mawr Community Council
Moelfre Community Council
Rhoscolyn Community Council
Trefeurig Community Council

Exhibit 6 - Councils with qualified audit opinions for three of the last four financial years

Council
Aber Community Council
Alaw Community Council
Bodfari Community Council
Briton Ferry Town Council
Bryneglwys Community Council
Carew Community Council
Cilcain Community Council
Clyne and Melincourt Community Council
Cynwyd Community Council
Ganllwyd Community Council
Genau'r Glyn Community Council
Llandyrnog Community Council
Llaneugrad Community Council
Llanfihangel y Pennant Community Council
Llangwm Community Council
Llangybi Fawr Community Council
Llanhennock Community Council
Llanover Community Council
Melindwr Community Council
Montgomery Town Council
Nefyn Community Council
Pentir Community Council
Queensferry Community Council
Ysbyty Ystwyth Community Council

- 2.11 A further 62 councils have received qualified opinions for two of the last four years.
- 2.12 In the Auditor General's view, it is unacceptable that councils fail to address weaknesses in their governance arrangements when these matters are drawn to their attention by the external auditor.
- 2.13 Where these qualifications are as a result of the council's failure to take appropriate action on issues that have previously been drawn to their attention, auditors are now required to consider whether these are matters which should be drawn to the public's attention at a local level.

Part 3

There is evidence of continuing failure to comply with statutory requirements with too many councils failing to meet required standards of governance in more than one area

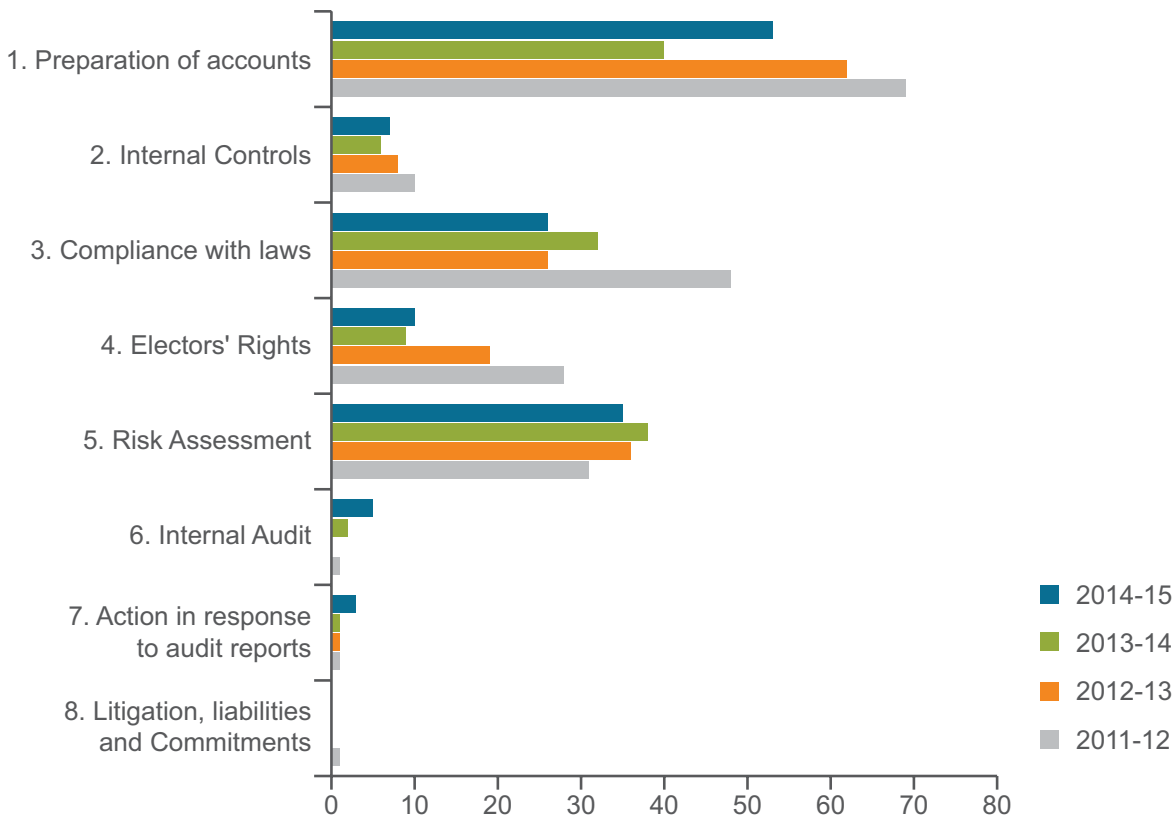


- 3.1 The majority of qualifications relate to the assertions made by councils in their AGS. In the AGS, councils make a positive statement that they have done what is required of them. **Appendix 1** of this report sets out the assertions made by councils in the AGS and provides a brief explanation of what the assurance given by a council means.
- 3.2 In many cases, when auditors examine these assertions they find that despite councils having given a positive response in the AGS, they have not in fact complied with the related requirements. In such cases, auditors qualify their audit opinion.

Auditors continue to identify recurring areas of non-compliance with councils' statutory responsibilities

- 3.3 **Exhibit 7** shows the number of qualifications relating to each of the assertions in the AGS. Some local councils have received a qualified opinion relating to two or more assertions.

Exhibit 7 - Number of qualifications related to each AGS assertion



- 3.4 The most common reason for qualifications related to the AGS in 2011-12, 2012-13 and 2013-14 was the failure to prepare and/or approve the annual accounts on time (assertion 1). For 2014-15 this remained the most common audit qualification with 53 (seven per cent) councils qualified in 2014-15 compared with only 40 in 2013-14 (five per cent). It is disappointing to note that this is a reversal of a downward trend since 2011-12.
- 3.5 As in previous years, the second most common reason for qualification for 2014-15 relates to assessing and managing financial and other risks (assertion 5). Statutory regulations state that local councils are responsible for putting in place and ensuring that there is a sound system of internal control which facilitates the effective exercise of their functions and which includes arrangements for the management of risk. Auditors qualify their opinions because of the council's failure to demonstrate that they meet their statutory responsibilities. Although there has been a small improvement across the sector this year, it is disappointing to note that risk assessment has been a recurring qualification theme for several years.
- 3.6 In the AGS (assertion 3), councils assert that they have taken all reasonable steps to ensure there are no matters of actual or potential non-compliance with laws, regulations and codes of practice that could have a significant financial effect on the council. A positive answer to this assertion means that the council has only done things that it has the legal power to do and has conformed to codes of practice and standards in the way it has done so.
- 3.7 Auditors test the AGS assertions on a sample basis and have noted the following issues in relation to lawfulness. In each of these cases, the council asserted that they comply with statutory requirements but the auditor has found that they do not. For example:
- Budget setting: Auditors identified 10 councils that had failed to calculate their budget requirement for the financial year as required by the Local Government Finance Act 1992. This will be an area of specific focus for the 2015-16 audits for all councils.
 - Pay As You Earn (PAYE) arrangements: Most local councils employ and pay salary or other allowances to the clerk. They must therefore operate a PAYE system to deduct income tax and national insurance contributions at source. Nevertheless, in 2014-15 auditors identified that 12 councils do not properly operate PAYE. PAYE was also a significant issue reported on for previous years.

- 3.8 The areas covered by the audit for 2011-12 to 2014-15 varied due to the local approaches taken by the Auditor General's appointed auditors. From 2015-16, auditors will be undertaking a consistent review across the sector as a whole. The 2015-16 audit will particularly focus on budget setting and monitoring and the appointment of internal audit. Different aspects of governance arrangements will be examined each year thereby allowing a full picture of governance arrangements across Wales to be seen.

Too many councils receive audit opinions that are qualified for two or more different reasons

- 3.9 Out of the 113 councils qualified in 2014-15, 74 councils (65 per cent) received audit opinions that were qualified for more than one reason. This compares with 41 councils (48 per cent) in 2013-14.
- 3.10 For 2015-16, the Auditor General will consider whether or not these are matters that should be reported to their communities in the public interest and whether or not to make statutory recommendations for improvement. Where auditors exercise these powers, there will be a significant additional cost to the council in terms of additional audit fees and potentially adverse local publicity, as well as possible loss of confidence from local communities.

Part 4

To help improve financial management and governance, the 2016-17 audit will examine arrangements for managing payroll and adoption of a Code of Conduct



- 4.1 The 2016-17 audit arrangements will continue to focus on thematic areas for review at all councils. These themes will vary year on year and will address concerns arising from audit findings.
- 4.2 In order to allow local councils to develop their governance arrangements, councils will be notified in advance of the specific areas that will form part of the thematic review each year. This arrangement will allow councils to identify areas where they need to improve their arrangements and to make any necessary improvements before the start of the financial year. However, it should be noted that this should not require councils to carry out any substantial additional work. Auditors will only seek evidence that all councils should readily have available.
- 4.3 The themes are identified based on particular areas of concern arising from auditors' work.

Auditors will examine councils' arrangements for management of payroll

- 4.4 As employers, council must operate PAYE in accordance with HMRC requirements. The Auditor General has noted that non-compliance is a recurring issue for the sector suggesting that councils' management of their payroll responsibilities may need improvement.
- 4.5 For the 2016-17 audit, auditors will focus on two aspects of effective payroll management – proper operation of PAYE and proper approval of staff pay awards.
- 4.6 Auditors will expect that councils will be able to provide the following evidence to support a positive assertion:
 - their employer number as issued by HMRC;
 - a copy of a PAYE returns to HMRC (councils will need to ensure that they retain copies of electronic submissions); and
 - minutes evidencing approval of staff pay awards for the year.

Auditors will examine the adoption of a Code of Conduct for members

- 4.7 The conduct of members is crucial to ensuring effective governance of town and community councils. The Welsh Government has exercised its power under section 50 of the Local Government Act 2000 to issue a model code as regards the conduct which is expected of members and co-opted members of town and community councils. The model code was issued as Schedule 1 of the Local Authorities (Model Code of Conduct) (Wales) Order 2008.
- 4.8 Section 51 of the Local Government Act 2000 places a duty on councils to adopt a Code of Conduct by resolution. Section 52 of the act requires all members to give a written undertaking that in performing their functions they will observe the council's Code of Conduct.
- 4.9 Auditors will expect that councils will be able to provide the following evidence to support their assertions:
- a copy of minutes confirming that the council has adopted a Code of Conduct; and
 - evidence that individual members have agreed to comply with the adopted code.

Appendices

Appendix 1 - The financial accountability framework for local councils

Appendix 2 - Annual Governance Statement assertions



Appendix 1 - The financial accountability framework for local councils

The Public Audit (Wales) Act 2004 (the Act) sets out the framework for financial accountability for town and community (local) councils in Wales. The main provisions in the Act are:

- all local councils must prepare annual accounts as at 31 March each year;
- these annual accounts are to be audited. For 2013-14, the auditor was appointed by the Auditor General;
- persons interested in the accounts may inspect the accounts and underlying accounting records; and
- local electors may ask questions of the auditor and make objections to the auditor about the accounts.

The Accounts and Audit (Wales) Regulations 2005 include further detail in relation to the above provisions:

- the council's responsible financial officer must certify that the accounts 'properly present' or 'present fairly' the council's transactions and balances;
- the council must approve the accounts after receipt of a report containing the auditor's final findings from the audit;
- once the audit has been concluded and the auditor has certified the accounts, the council must publish the accounts;
- these provisions are subject to fixed deadlines; and
- councils must also make arrangements for members of the public to exercise their inspection rights under the Act.

The Act also sets out the responsibilities of the external auditor to give an opinion on the accounts in compliance with the Auditor General's Code of Audit Practice (the Code).

The Code specifies a limited assurance framework for local councils with annual income and expenditure of up to £1 million to provide a level of assurance commensurate with the amounts of public money managed by local councils.

The Code does not require a full audit in accordance with professional auditing standards. The Code requires external auditors to examine the accounts and any additional information and explanation provided. As well as information provided by the councils themselves, auditors consider information provided by members of the public and press coverage etc that comes to their attention.

Appendix 2 - Annual Governance Statement assertions

Method	'Yes' means that the council
1 We have approved the accounting statements which have been prepared in accordance with the requirements of the Accounts and Audit (Wales) Regulations 2005 (as amended) and proper practices.	Prepared its accounting statements in the way prescribed by law.
2 We have maintained an adequate system of internal control, including measures designed to prevent and detect fraud and corruption, and reviewed its effectiveness.	Made proper arrangements and accepted responsibility for safeguarding the public money and resources in its charge.
3 We have taken all reasonable steps to assure ourselves that there are no matters of actual or potential non-compliance with laws, regulations and codes of practice that could have a significant financial effect on the ability of the council to conduct its business or on its finances.	Has only done things that it has the legal power to do and has conformed to codes of practice and standards in the way it has done so.
4 We have provided proper opportunity for the exercise of electors' rights in accordance with the requirements of the Accounts and Audit (Wales) Regulations 2005 (as amended).	Has given all persons interested the opportunity to inspect and ask questions about the council's accounts.
5 We have carried out an assessment of the risks facing the council and taken appropriate steps to manage those risks, including the introduction of internal controls and/or external insurance cover where required.	Considered the financial and other risks it faces in the operation of the council and has dealt with them properly.
6 We have maintained an adequate and effective system of internal audit of the council's accounting records and control systems throughout the year and have received a report from the internal auditor.	Arranged for a competent person, independent of the financial controls and procedures, to give an objective view on whether these meet the needs of the council.
7 We have taken appropriate action on all matters raised in previous reports from internal and external audit.	Has responded to matters brought to its attention by internal and external audit.
8 We have considered whether any litigation, liabilities or commitments, events or transactions, occurring either during or after the year-end, have a financial impact on the council and, where appropriate, have included them on the accounting statements.	Disclosed everything it should have about its business during the year including events taking place after the year-end if relevant.
9 Trust funds – in our capacity as trustee we have: <ul style="list-style-type: none"> • discharged our responsibility in relation to the accountability for the fund(s) including financial reporting and, if required, independent examination or audit. 	Has met all of its responsibilities where it is a sole managing trustee of a local trust or trusts.

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