

Archwilydd Cyffredinol Cymru  
Auditor General for Wales

# Internal Audit Arrangements at Town and Community Councils in Wales



WALES AUDIT OFFICE  
SWYDDFA ARCHWILIO CYMRU



I have prepared and published this report in accordance with the  
Public Audit (Wales) Act 2004

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**Mae'r ddogfen hon hefyd ar gael yn Gymraeg.**

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## Summary Report

### What this review is about

- 1 The Accounts and Audit (Wales) Regulations 2014 require town and community councils to have adequate and effective arrangements in place for an internal audit of their accounting records and their systems of internal control.
- 2 Over the past 10 years, there have been several cases of community councils suffering losses to the public purse due to significant failures in financial management and governance. In some instances, this has been due to fraud and theft. While the sums involved are small in relation to total public spending in Wales, they are significant to the individual communities concerned and could have been avoided if there were effective internal audit arrangements in place.
- 3 In most of these cases, the external auditors have identified issues with the scope and adequacy of the work carried out by internal audit. External auditors frequently identify that internal auditors are appointed by the council's clerk with limited input, supervision or contact from the council itself. In a small number of recorded cases, this has resulted in clerks falsifying the existence of internal audit.
- 4 In his report on the 2015-16 Town and Community Councils in Wales accounts, the Auditor General commented on the contradictory conclusions drawn by internal and external auditors in relation to specific issues such as budget setting.
- 5 The Auditor General's statutory audit arrangements are based upon limited assurance which is proportionate to the scale of the sector. The limited assurance audit addresses the duties of the Auditor General through three key elements:
  - a compliance test against the requirements of the annual return;
  - a high level analytical review of the financial and other information provided to the auditor; and
  - a review of the two-part annual governance statement provided by the body and the supporting report from its internal auditor.
- 6 However, in setting these arrangements, there is an assumption that councils have adequate and effective internal audit arrangements in place. There is a reputational risk to the Auditor General's regime where significant issues including fraud are identified, as well as a loss of public confidence in the councils concerned.

7 **Appendix 1** sets out our audit approach and methods.

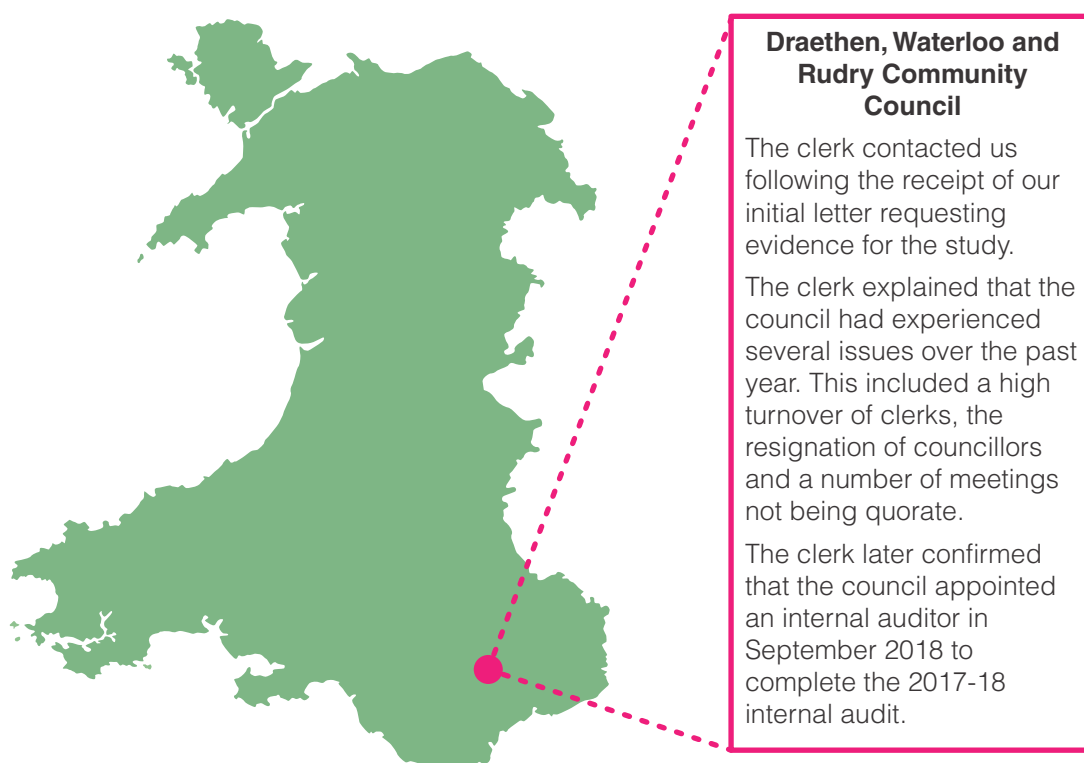
## Key Findings

- 8 The messages in this study are consistent with the increasing number of cases of poor governance that we have seen in community councils, which have prompted several public interest reports and statutory recommendations over the last year. **Financial Management and Governance in Town and Community Councils 2017-18** has provided further detail on the public interest reports and statutory recommendations issued during 2018.
- 9 Our main findings, based on a sample of 113 of Wales' 735 town and community councils, are as follows:
- we were unable to establish if internal audit arrangements were in place for around one in ten councils in our sample;
  - one in five councils in our sample do not have a sufficiently independent internal auditor;
  - two-thirds of councils in our sample have inadequate terms of reference for their internal auditor;
  - internal audit conclusions were inaccurate at one in three councils sampled;
  - there are inconsistencies in the internal audit annual reporting process;
  - most councils in our sample did not formally document how they are addressing internal audit recommendations; and
  - a third of internal auditors interviewed felt that additional testing and fee charging guidance would be beneficial.
- 10 As reported in **Financial Management and Governance in Town and Community Councils 2017-18**, the Auditor General will review the audit arrangements for the sector during 2019-20. This report on internal audit will provide evidence for that review.

## Part 1 – We were unable to establish if internal audit arrangements were in place for around one in ten councils in our sample

- 1.1 The Auditor General has set statutory audit arrangements proportionate to the size of the sector. However, in setting these arrangements, there is an assumption that all councils have adequate and effective internal audit arrangements in place.
- 1.2 Whilst undertaking the review we contacted 113 of Wales' 735 community councils requesting they provide the contact details of their internal auditor. The clerk of Draethen, Waterloo and Rudry Community Council responded immediately stating the Council did not have an internal auditor. This was the only council in our sample without an internal auditor. **Exhibit 1** explains the situation at the council in more detail.

**Exhibit 1: the location of Draethen, Waterloo and Rudry Council and the information provided by the clerk**



Source: Response provided to the Wales Audit Office questionnaire by Draethen, Waterloo and Rudry Council Clerk

- 1.3 Of the 112 remaining councils sampled, we were unable to contact ten of the internal auditors. The ten instances of non-contact can be broken down as follows:
- five councils in our sample did not respond to our study
  - three councils provided a response to the study, including contact details for their internal auditors, during the external clearance process in December 2018;
  - one council did not provide sufficient contact details for their internal auditor; and
  - one internal auditor did not respond to our request for evidence.
- 1.4 We were therefore unable to obtain any assurance that these councils have in place any internal audit arrangements.
- 1.5 **Exhibit 2** shows those councils in our sample where the internal auditor could not be contacted.

Exhibit 2: the councils in our sample where we were unable to establish if internal audit arrangements were in place



Source: Responses provided to the Wales Audit Office

- 1.6 **Case Study 1** provides further details which underline the difficulties faced by the audit team.

### **Case Study 1: Merlin's Bridge Community Council - limited contact details for internal auditor**

The council's usual internal auditor was unavailable for 2017-18, so the council used a new internal auditor. The new auditor was found at short notice but held financial qualifications. We were given contact details for the auditor; name and mobile number.

After several attempts at contacting the auditor, including leaving messages, we requested additional contact details (including a postal address and email address) from the clerk. However, the clerk has been unable to provide them, and the internal auditor has not responded to our messages.



Source: Response to Wales Audit Office questionnaire

- 1.7 Non-responses from councils and internal auditors (see **Exhibit 2**) are particularly disappointing and contravene the Auditor General's access rights under Section 52 of the Public Audit (Wales) Act 2004. This Act states that the Auditor General for Wales, or auditors acting on his behalf, have the right of access to every document relating to a body subject to audit. This legislation applies to town and community councils, clerks and internal auditors.
- 1.8 Given the lack of assurance the Auditor General has over the internal audit arrangements at the councils shown in **Exhibit 2** he will regard those councils as being high-risk bodies from 2018-19 onwards.
- 1.9 There were also instances where councils and internal auditors in our sample failed to supply the information we requested. These have been listed within **Exhibit 3** below. The timeline for contacting the councils and internal auditors who were part of the sample can be seen within **Appendix 2**.

Exhibit 3: councils and internal auditors who have presented incomplete information for audit.

<b>Councils which have not provided all the information requested</b>
<ul style="list-style-type: none"><li>• Coedpoeth Community Council</li><li>• Maentwrog Community Council</li><li>• Merlin's Bridge Community Council</li><li>• Ruabon Community Council</li></ul>
<b>Councils where we established contact with the internal auditor, but they did not respond to our request for information</b>
<ul style="list-style-type: none"><li>• Llanwddyn Community Council</li></ul>
<b>Councils where the internal auditor has stated they have working papers, but did not provide them</b>
<ul style="list-style-type: none"><li>• Aberffraw Community Council</li><li>• Abermule with Llandyssil Community Council</li><li>• Bodedern Community Council</li><li>• Pentraeth Community Council</li></ul>
<b>Councils where the council or internal auditor provided the requested information during the clearance process in December 2018</b>
<ul style="list-style-type: none"><li>• Honddu Isaf Community Council</li><li>• Llanllwni Community Council</li></ul>

Source: information received by the Wales Audit Office

- 1.10 The failure to provide information for this study is consistent with wider difficulties in obtaining information from town and community councils. **Financial Management and Governance in Town and Community Councils 2017-18** also highlights deficiencies in presenting information for audit.

## Part 2 – One in five councils in our sample do not have a sufficiently independent internal auditor

- 2.1 **Governance and Accountability for Local Councils in Wales: A Practitioners' Guide** (the Practitioners' Guide) provides guidance on when an internal auditor would not be sufficiently independent. These circumstances include where the internal auditor:
- a is involved in the council's management or administrative roles, for example if they are also a councillor;
  - b assists with bookkeeping or preparing the statement of accounts; or
  - c offers advice on the council's financial controls and procedures.
- 2.2 An additional threat to independence would be if the internal auditor was a friend or relative of the clerk, or other councillors. This would compromise the auditor's independence as they might be less likely to raise issues found, and more likely to trust to explanations given by the clerk or council without appropriate scrutiny. There would also be the possibility that the auditor could collude with the clerk.
- 2.3 **Case Study 2** gives an example of an auditor who we do not consider to be sufficiently independent.

## Case Study 2: Bishopston Community Council - lack of internal auditor independence

Detail	Sufficiently independent
The Associated Accounting Technician qualified internal auditor is a friend of the council clerk.	
She assists in the completion the council's monthly bank reconciliations and checks the council's cash books.	
She also assists in the preparation of the council's annual accounts and VAT returns, as well as undertaking any general office duties requested by the clerk.	



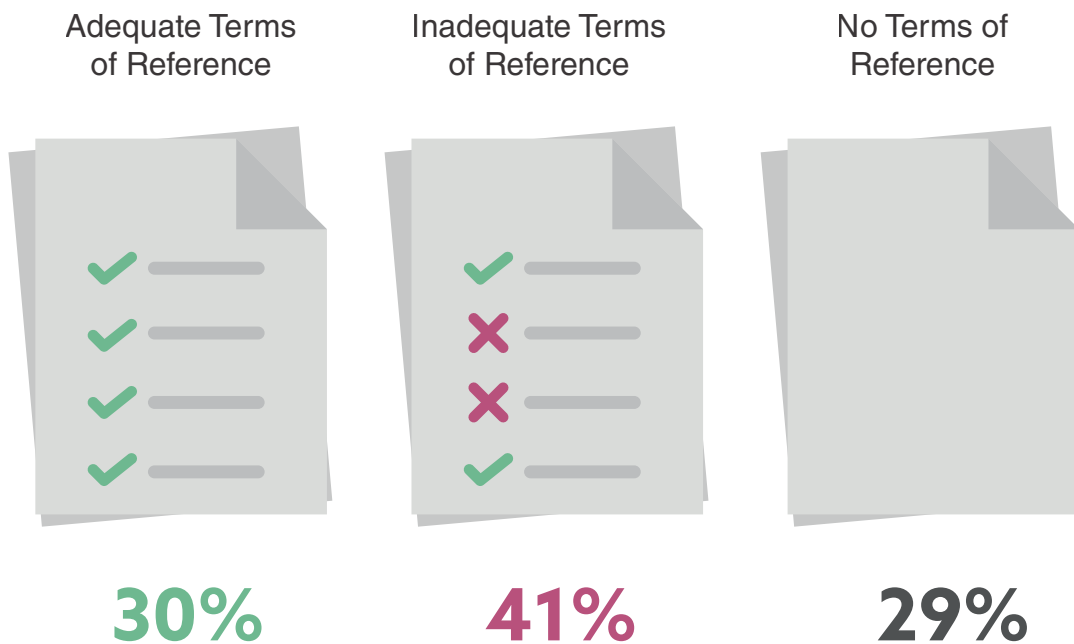
Source: Documentation received

- 2.4 External auditors regularly raise the issue of internal auditors providing other services as part of their normal audit procedures. This has been backed-up by our fieldwork which found that 21% of councils in our sample had internal auditors whose independence was insufficient, mainly due to the provision of additional services. The most common services provided by internal auditors were preparing the annual accounts, providing payroll services and preparing bank reconciliations for the council.
- 2.5 By completing additional services, the internal auditor is not acting independently as when they undertake the internal audit they are assessing their own work. This raises an ethical conflict and a risk that issues with the accounts may not be flagged, thereby undermining the robustness of the completed internal audit.

## Part 3 – Two-thirds of councils in our sample have inadequate terms of reference for their internal auditor

- 3.1 Councils should actively oversee their internal control arrangements by discussing the appointment of, and then formally appointing, the internal auditor. This oversight ensures that a suitable individual or firm is appointed to carry out the work.
- 3.2 We were pleased to find that 91% of councils in our sample had formally minuted the appointment of their internal auditor. We understand that the appointments process does not necessarily happen year-on-year with only 74% of those sampled being minuted in 2017-18. However, considering most councils in our sample displayed attributes of good governance by formally minuting the appointment of their internal auditor, it was disappointing to see that this was not continued to the internal auditor's terms of reference.
- 3.3 We compared each terms of reference received to the suggested format as noted within the Practitioners' Guide. The list below shows the areas which are expected to be covered:
  - a Roles and responsibilities
  - b Audit planning
  - c Reporting requirements;
  - d Assurances around independence and competence
  - e Access to information, members and officers
  - f Period of engagement
  - g Remuneration
  - h Any other matters required for the management of the engagement by the council
- 3.4 The comparison undertaken highlighted that two-thirds of councils in our sample did not have terms of reference or where they did, those terms were not adequate. **Exhibit 4** shows our evaluation when completing the comparison.

**Exhibit 4: evaluation of terms of reference by percentage of councils in our sample**



Source: Wales Audit Office analysis

- 3.5 As shown in [Exhibit 4](#), only 30% of councils in our sample had terms of reference which adequately set out the relationship with the internal auditor, and the arrangements in place for the internal audit. In [Appendix 3](#), we have provided a copy of Goetre Fawr Community Council's terms of reference for its internal auditor. This covers all areas recommended in the guidance, however, we have also added footnotes to suggest how the document could be further improved.
- 3.6 A further 41% of councils in our sample had terms of reference in place, but they did not adequately set out the arrangements and relationship. For example, some terms did not specify the scope of the work to be carried out during the internal audit or did not adequately set out the respective roles and responsibilities of the council and the internal auditor.
- 3.7 Of the councils sampled, 29% did not have terms of reference in place. This increases the risk of misunderstandings between the council and the internal auditor. Furthermore, the councils concerned do not have assurance over the extent and adequacy of their internal audit arrangements.

## Part 4 – Internal audit conclusions were inaccurate at one in three councils sampled

- 4.1 We requested internal audit working papers, internal and external audit reports for each of the councils selected to compare audit conclusions. We have been unable to complete the comparison for 21% of our sample, as at present the external audits at those councils have not been completed. This is due to three non-submissions and 20 councils where issues have been identified.<sup>1</sup>
- 4.2 Where we have been able to compare the findings of the internal auditor and the external auditor, we found that at 41 councils (46% of the councils where we received the audited annual return) the internal auditor failed to identify issues subsequently identified by the external auditor. This finding indicates weaknesses in the internal audit work completed, as the auditor has failed to identify issues with the council's internal control system.
- 4.3 We have highlighted two examples to provide context to the information presented in [paragraph 4.2](#). The first example, [Case Study 3](#), shows where an internal auditor reached opposing conclusions to the external auditor and [Case Study 4 \(paragraph 4.7\)](#) shows where the internal auditor identified weaknesses but failed to report them.

<sup>1</sup> Further details of issues relating to the certification of annual returns are discussed in [Financial Management and Governance in Town and Community Councils 2017-18](#).

### Case Study 3: Bodedern Community Council - Internal auditor failed to identify issues raised by the external auditor

The council received a qualified audit opinion from the external auditor with several different issues flagged. However, no issues were flagged on the annual return by the internal auditor. The differences between the findings of the internal and external auditors included the following:

- Budgetary Process:
  - the external auditor found that although a precept was set by the due date the council did not prepare an adequate budget to support and evidence the precept request, and no budget monitoring has been undertaken as there is no budget with which to compare actual figures; and
  - the internal auditor wrote in his report that the council had adopted an appropriate budget process, identifying what was required and anticipated expenditure to determine the level of precept required. He also reported that the budget was monitored during the year.
- Asset Register:
  - the external auditor found that the council's asset register was incomplete and did not contain adequate information for all assets; and
  - the internal auditor wrote in his report that there was evidence that the council had an adequate asset register.



Source: Documentation received

- 4.4 In our view **Case Study 3** brings into question the adequacy of the work undertaken by the internal auditor. This is disputed by the clerk of Bodedern Community Council.
- 4.5 Our concerns when internal auditors reach different conclusions from external auditors include:
- a that the internal auditor did not complete adequate work to support the conclusions they drew; and
  - b that the internal auditor did not properly understand the processes they were reporting on.
- 4.6 This is not an isolated example. In all the cases reported in **paragraph 4.2**, we would have expected the internal auditors to have picked up the issues identified by the external auditor if they had completed all the work indicated in their working papers and/or audit report.

- 4.7 The current external audit process relies on internal auditors completing adequate work to support the statements in the Internal Audit section of the Annual Return. If reliance cannot be placed on the conclusions reached by a significant proportion of internal auditors, the internal audit and limited assurance external audit process is undermined.
- 4.8 **Case Study 4** highlights an internal auditor identifying issues and then not reporting them within their report.

#### **Case Study 4: Trefeurig Community Council - Failure to adequately disclose audit findings**

We examined the working papers and audit report produced by the internal auditor for the council. He had identified several deficiencies with the council's internal controls, including the following:

- not all invoices/vouchers were made available for the audit;
- not all payments made had been approved for payment by the council;
- a duplicate payment was identified in the accounts;
- £326.07 of expenses reimbursed to the clerk had not been approved by the council;
- vouchers had been provided for expenses payments to the clerk instead of original invoices;
- there was no evidence that the council monitors income and expenditure against the budget during the year;
- for two months of the year, duplicate salary payments had been made to the clerk, which had not been identified until the clerk prepared the end-of-year accounts; and
- the asset register contained no monetary values.

These issues were included in the detailed internal audit report. However, this report was not presented to council.

Despite identifying these issues, the overall conclusion within the Annual Return was that the council's system of internal control was adequate and met required standards.

This disparity between the findings disclosed in the detailed audit report and the annual return was highlighted by the external auditor.



Source: Documentation received

4.9 **Case Study 4** demonstrates that the auditor completed sufficient work on the council's accounts and systems of internal control. However, the internal auditor's satisfactory conclusion is inconsistent with the findings of the audit work. An unqualified opinion was given on the adequacy of internal controls although a several issues were identified. We consider issues relating to the reporting of internal audit findings in more detail in section 5 of this report.

## Part 5 – There are inconsistencies in the internal audit annual reporting process

5.1 The internal audit section on the Annual Return requires the internal auditor to include an outline of the work undertaken, or to provide a separate, detailed internal audit report to the Council. This informs the councillors' conclusions for section six of the Annual Governance Statement which requires councillors to confirm:

'We have maintained an adequate and effective system of internal audit of the accounting records and control systems throughout the year and have received a report from the internal auditor.'

Having signed section six, councillors are confirming the existence of internal control.

5.2 Our findings indicated that councils in our sample find it difficult to answer section six for two reasons:

- firstly, some internal auditors do not provide sufficient reports on the work they have undertaken, see [Exhibit 5](#) for detail; and
- secondly, certain clerks do not report the findings of the internal auditor to the council, see [paragraph 5.8](#).

5.3 [Exhibit 5](#) summarises the proportion of our sample where sufficient reports of internal audit work were made.

Exhibit 5: analysis of internal audit reports by percentage of councils in our sample



Source: Wales Audit Office review of audit reports and annual returns

- 5.4 **Case Study 5** describes one of the councils where the internal auditor stated he had provided an additional audit report, but it was inadequate.

#### **Case Study 5: Llandysul Community Council - insufficient internal audit report**

The internal auditor ticked yes to all the relevant statements on the internal audit section of the annual return but did not include any comments. He stated on the annual return that he had provided a separate audit report to the council.

The separate audit report provided by the auditor was a single sentence. It stated: 'I confirm that I have examined the accounts as at 31 March 2018 and on the information provided found to be correct.'

The report is then signed and dated by the internal auditor.



**Source: Documentation received**

- 5.5 **Case Study 5** demonstrates the lack of information in some of the internal audit reports provided to councils in our sample. This level of information does not allow the council to understand what work has been undertaken by the internal auditor and does not allow the council to give an informed response to the annual governance statement.
- 5.6 In **Appendix 6**, we have re-produced Holyhead Town Council's internal audit report as an example of good practice. It concisely sets out the work undertaken during the internal audit, the conclusions reached by the internal auditor and recommendations for action to be taken to improve the system of internal control.
- 5.7 Our findings highlighted that in 6% of councils sampled, the clerk did not report the findings of the internal auditor to the council. This means the council is unable to scrutinise the work of the internal auditor. We consequently have concerns over how they can have sufficient assurance to sign off positive assertions in the Annual Governance Statement.
- 5.8 Councillors should ensure that they receive a copy of the internal auditor's report to enable them to determine the adequacy of the internal audit arrangements.

## Part 6 – Most councils in our sample did not formally document how they are addressing internal audit recommendations

- 6.1 Our study found that 56% of councils in our sample had received recommendations from their internal auditor during the 2017-18 audit. However, only seven councils had put formal arrangements in place to ensure the recommendations were addressed, in the form of an action plan. Five of these councils had the action plan provided by their internal auditor.
- 6.2 We have included an example of good practice in an action plan provided to Lllysfaen Community Council by its internal auditor in [Appendix 5](#). In subsequent years, the actions remain on the action plan, and the internal auditor confirms whether they have been actioned, or whether they are outstanding.
- 6.3 We would recommend that councils should consider creating action plans to document internal and external audit recommendations. If an action plan is provided by the internal auditor, such as the example in [Appendix 5](#), additional columns could be added to document who is going to action the recommendation, the timescale and how it will be reported, as well as a column to note when actions have been completed. By doing this, councils would be able to keep a record of the recommendations that had been made and ensure that they comply with them to improve their internal control environment.
- 6.4 Additionally, we found that the main follow-up work completed on the recommendations from the internal audit is by the internal auditor in the following year. Although 87% of internal auditors making recommendations told us that they follow up on them the following year, we feel that it is important for councils to monitor their own progress in addressing recommendations made.
- 6.5 From our review of working papers, we have noted 9% of councils in our sample do not appear to be addressing audit recommendations from previous years. These councils had outstanding internal audit recommendations from 2016-17 detailed on their internal audit report for 2017-18, as described in [Case Study 6](#).

### **Case Study 6: Carreghofa Community Council - Failure to address recommendations**

The 2017-18 internal audit report for the council highlighted several issues, including the following:

- the annual return did not add up correctly;
- un-presented cheques had been incorrectly included as creditors;
- VAT had not been reclaimed since 2014-15;
- year-end reserves were very high, but not earmarked for specific purposes; and
- there were issues with the budget setting process.

All of these issues were previously identified by the internal auditor during the 2016-17 audit.



**Source: documentation received**

- 6.6 The fact that the issues in **Case Study 6** reoccurred in 2017-18 after being reported in 2016-17 suggests that the council does not have adequate procedures in place to deal with recommendations. This demonstrates why it is important for councils to make sure that they have suitable arrangements in place to make changes following internal audit recommendations, and to monitor their progress.

## Part 7 – A third of internal auditors interviewed felt that additional testing and fee charging guidance would be beneficial

- 7.1 All but three of the internal auditors in our sample held financial qualifications or had relevant experience for their internal audit role. However, of the 19 interviewed a third of them indicated they would appreciate additional guidance to confirm what was expected of them in relation to certain areas of the annual return.
- 7.2 The most common areas where they asked for additional guidance were the following statements on the annual internal audit report section of the annual return:
- 3. the body assessed the significant risks to achieving its objectives and reviewed the adequacy of arrangements to manage these; and
  - 4. [...] progress against the budget was regularly monitored, and reserves were appropriate.
- 7.3 On reviewing our sample, it was clear that reserve testing was an area of weakness for internal auditors. In 19 instances internal audit concluded that reserves were appropriate, however external audit concluded that reserves were too high or too low.
- 7.4 During our fieldwork, we identified examples of good practice in relation to these areas, which we have shared here to assist other internal auditors ([Case Studies 7 and 8](#)).

### Case Study 7: Gwernymynydd Community Council - risk management arrangements

The internal auditor attends a council meeting every October to facilitate a discussion about risks.

The output of the meeting is a risk assessment which includes the risks that the council faces, their consequences and actions the council is or could take to mitigate them.



Source: Documentation received

- 7.5 Facilitating the risk meeting in [Case Study 7](#) enables the internal auditor to gain an appreciation of the council's attitude towards risks, and whether they are seriously considering how to mitigate the risks they face.

- 7.6 We appreciate that not all auditors may be able to attend a full council meeting for each council that they audit. However, the critical scrutiny of risk assessments and risk management arrangements for completeness and adequacy would assist auditors to reach an informed conclusion.

### **Case Study 8: Penyrheol, Trecenydd and Energlyn Community Council – budget monitoring arrangements**

The internal auditor told us that he can easily check whether the council is monitoring its budget through the quarterly reports which the clerk presents to the council.

The clerk prepares a report analysing the quarter's income and expenditure and reconciling it to the bank accounts. The report is then presented to the council, and progress against the budget is discussed. It is also considered whether any changes to the budget are required.

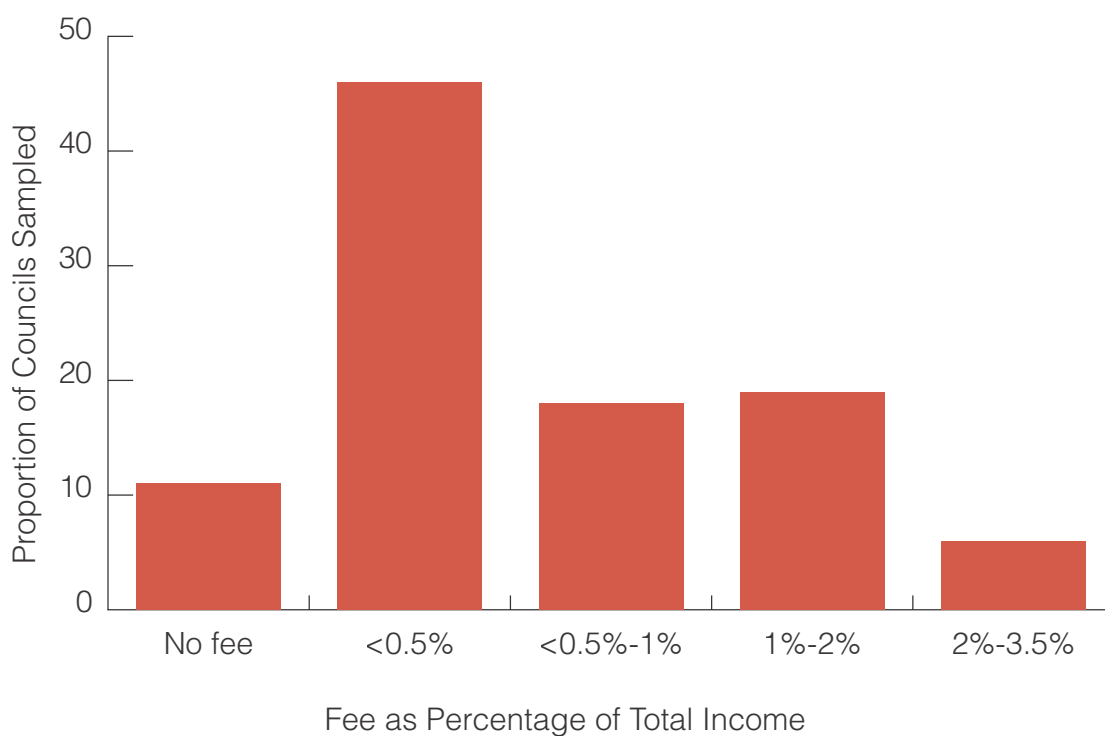
The internal auditor checks the council's minutes and the quarterly financial reports to confirm whether they are monitoring progress against the budget.



**Source:** Interview with the internal auditor

- 7.7 **Case Study 8** shows how council's can monitor their own financial position and suggests what sort of documentation internal auditors should be looking for to gain assurance over the council's budget monitoring arrangements.
- 7.8 We have also included the internal audit work programme used for Builth Wells Town Council in **Appendix 4**, which is an example of good practice in undertaking internal audit testing.
- 7.9 Some internal auditors told us that they were unsure what fee to charge for their work. We have, therefore, compiled information about the internal audit fees for the councils in our sample, with the results summarised in **Exhibit 6**.

## Exhibit 6: Internal audit fees charged as a percentage of council income

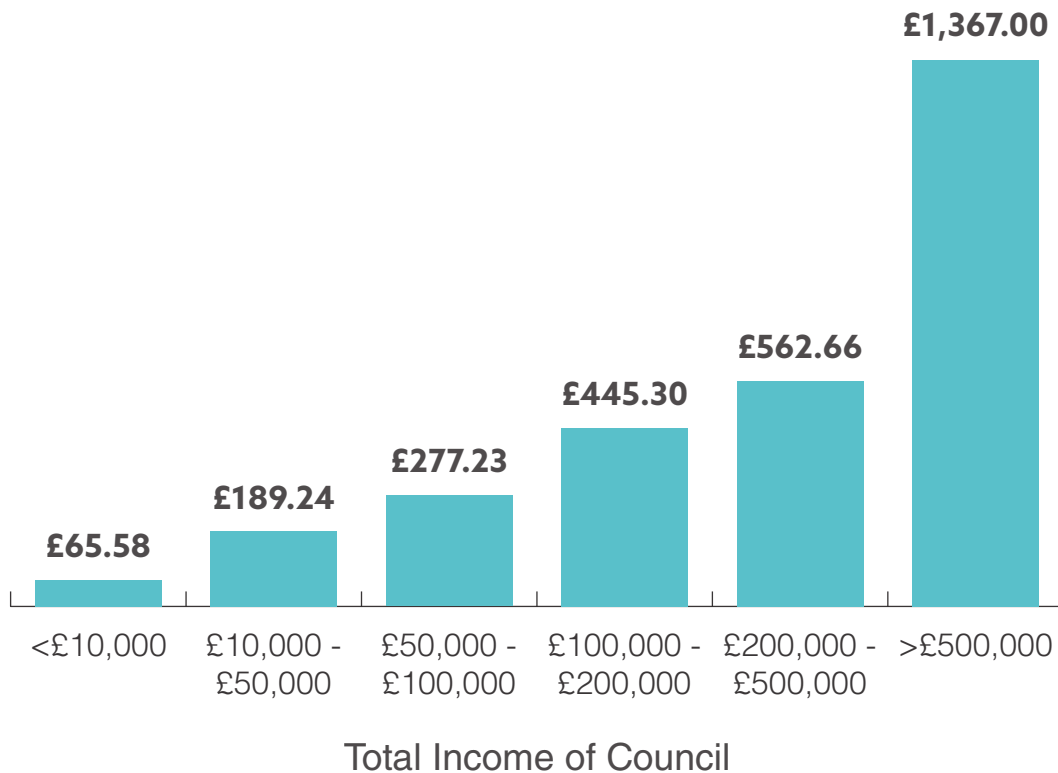


Source: Wales Audit Office analysis

7.10 **Exhibit 6** shows that there is a significant variation in the fees charged by internal auditors. The majority charge less than 0.5% of the council's income, but one quarter charge between 1% and 3.5% of the council's income.

7.11 We have also analysed the average audit fees paid by councils of different sizes in **Exhibit 7**.

Exhibit 7: mean audit fees for councils in our sample in different size brackets



Source: Wales Audit Office analysis

7.12 Some internal auditors do not charge a fee for their services. Within our sample, 11% of councils were not charged for their internal audit. These councils varied in size, from total incomes of £950 to £67,033 in 2017-18.

# Appendices

## Appendix 1 – Our Audit Approach and Methods

### Scope

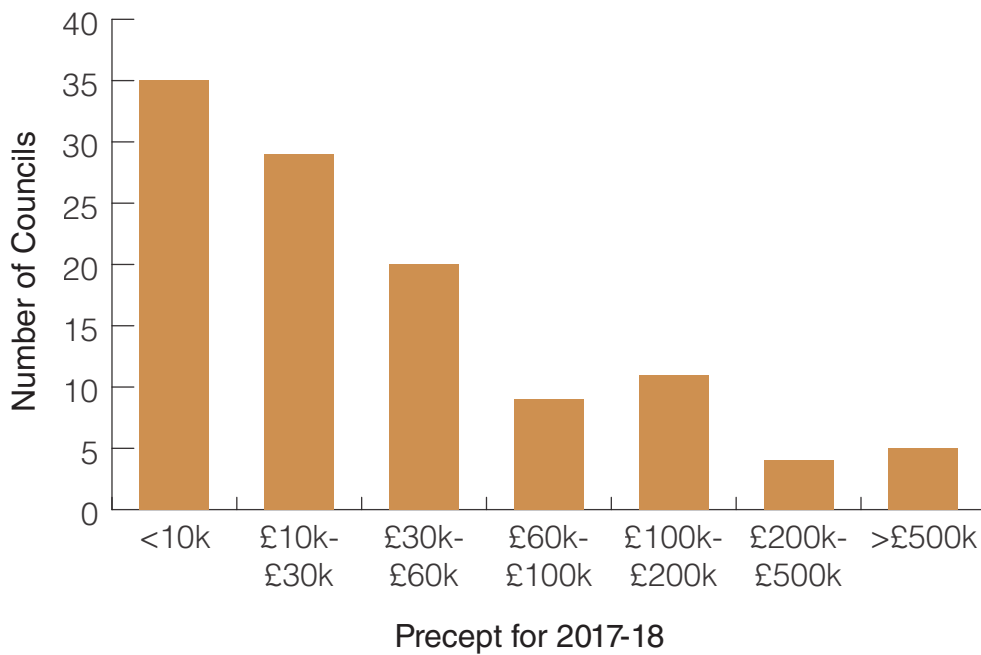
- 1 We conducted an audit review of the adequacy and effectiveness of the internal audit arrangements in place for town and community councils.

### Methods

- 2 We gathered and reviewed documentary evidence from 113<sup>2</sup> of the 735 town and community councils. The top seven councils in terms of the higher level of expenditure were selected automatically with the remainder being selected on a random basis, see **Exhibit 8**, below for the varying levels of precept.
- 3 The documentary evidence included:
  - a 2017-18 Certified annual returns;
  - b responses to our questionnaire, sent out to both clerks and internal auditors; and
  - c internal audit working papers.

<sup>2</sup> Sample size was determined using our internal sample selection formula.

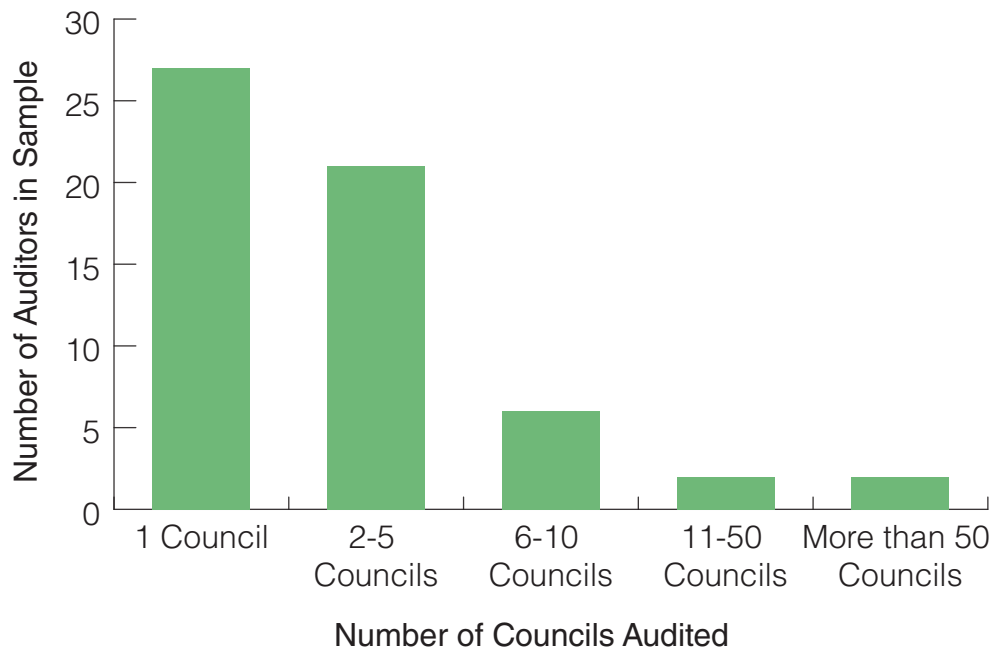
Exhibit 8: size of councils included in the study by precept



Source: WAO Analysis

- 4 Our sample of 113 councils involved contacting 60 internal auditors for information in relation to their internal audit arrangements and the 2017-18 internal audit, the number is less than our sample size as some auditors work with more than one council, see [Exhibit 9](#).

Exhibit 9: total number of councils audited by internal auditors within our sample



Source: Wales Audit Office Analysis

- 5 Based on the information received we interviewed 19 internal auditors. Exhibit 10 shows the questions that we were seeking to answer.

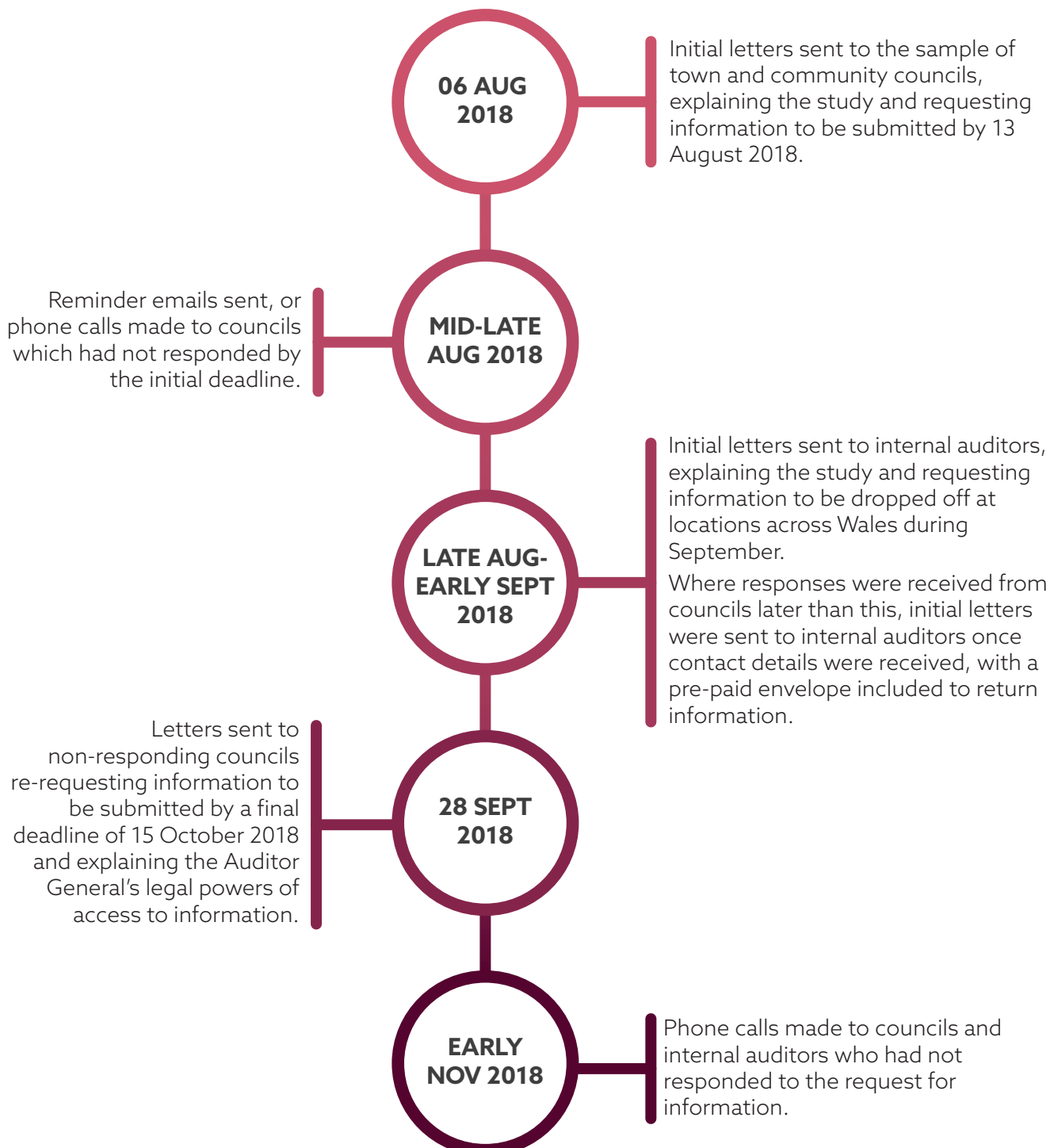
Exhibit 10: indicates the questions that we were seeking to answer via the study.

Overall audit question
Is internal audit in town and community councils in Wales adequate and effective?
Second-level questions
Is internal audit sufficiently independent of individual councils? Are internal auditors provided with adequate terms of reference setting out the scope of their work? Is internal audit work properly carried out and conclusions supported by adequate evidence? Do internal auditors provide sufficient and appropriate reports to councils setting out their conclusions and recommendations? Do councils take appropriate action in response to recommendations made by internal audit?

Source: Wales Audit Office project initiation document

- 6 We have provided the opportunity to the town and community councils mentioned within the report and to named third parties for them to provide comments on our report prior to publication, in relation to factual accuracy, completeness and balance.
- 7 Our published report sets out the underlying facts, the Auditor General's conclusions and his specific recommendations to the town and community councils.

## Appendix 2 – Timeline for Information Requests during the Study



## Appendix 3 – Good Practice – Terms of Reference

### Internal Audit Engagement Letter: Goetre Fawr Community Council

I wish to confirm your appointment as Internal Auditor to the Council and set out below the terms of your engagement. If you agree, I should be grateful if you would sign and return one copy for my records.

#### 1. Roles and responsibilities

Of the Council:

- 1.1 The Council is responsible for ensuring that its financial management is adequate and effective and that it has a sound system of internal control which facilitates the effective exercise of its functions including arrangements for the management of risk.
- 1.2 The Council is required to undertake an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control set out in the Joint Practitioners Advisory Group publication: Governance and Accountability for Local Councils: A Practitioners Guide and attached schedule of audit checks produced by One Voice Wales.

Of the Internal Auditor:

- 1.3 The Internal Auditor is responsible for reviewing whether the Council's financial management is adequate and effective, and that it has a sound system of internal control. The Internal Auditor will liaise with the Clerk to the Council and will report to the Council at least once a year.

#### 2. Audit planning

- 2.1 The Council has in place a strategic audit plan covering the main governance and financial systems and this is reviewed annually. Further guidance, including a description of the minimum level of audit, is set out in the Practitioners Guide.
- 2.2 The Internal Auditor will carry out the audit to enable him/her to provide assurance to members and officers, and to enable him/her to complete and sign off Section 4 of the Annual Return in advance of its submission to the Council and the external auditor.
- 2.3 The programme of work for the year will be determined annually between the Clerk<sup>3</sup> and the Internal Auditor prior to the commencement of work.

<sup>3</sup> We would recommend that this should instead read 'between the Council'.

### 3. Reporting requirements

- 3.1 The Internal Auditor will report to the Council, setting out the results of work carried out during the previous twelve months.
- 3.2 To enable the Internal Auditor to fully complete Section 4 of the Annual Return, he/she will carry out work relating to the year-end in April/May. The results of such work will be reported alongside the presentation of the Annual Return to the Council.

### 4. Independence and competence

- 4.1 It is essential that the internal audit function is sufficiently independent of other financial controls and procedures of the Council.
- 4.2 The Internal Auditor will inform the Clerk immediately if he/she becomes aware of any conflict of interest that may adversely affect his/her ability to carry out the audit objectively and independently.
- 4.3 The Internal Auditor will carry out the internal audit competently and in compliance with proper practice in a way that will meet the business needs of the Council. If the Internal Auditor becomes aware of matters that may affect his/her competence, he/she will inform the Clerk or the Chairman immediately.

### 5. Access to information, members and officers

- 5.1 The Internal Auditor shall have the right of access during the audit to such accounts, vouchers, correspondence, accounting systems, minutes and other records as are necessary for the performance of the audit.
- 5.2 The Internal Auditor shall have the right of access to any member or officer to discuss and to receive information and explanations in connection with any matter arising from the audit.

### 6. Period of engagement

- 6.1 The Internal Auditor is appointed for an unspecified period, but subject to annual confirmation by the Council.

## 7. Remuneration

- 7.1 It is agreed between the Internal Auditor and the Council that the fee shall be a fixed rate of £100<sup>4</sup> including all expenses (although any auditor's travel costs of 45p/mile will also be payable.)
- 7.2 This rate is fixed for the period of the contract. Payment will normally be made on invoice, based on the work completed.
- 7.3 In the event that additional paid work is required, the terms of this will be agreed between the Council and the Internal Auditor in advance of the assignment at the same daily rate as above and invoiced separately.

<sup>4</sup> This should specify whether the rate is per hour/per day.

## Appendix 4 – Good Practice – Work Programme

### Exhibit 11: Internal Audit Work Programme: Builth Wells Town Council

1. Internal Control	2. Tests	3. Initial if Yes	4. Working Paper Reference	5. Comments
Previous Internal Audit Report	Do the minutes record that Council has considered the Internal Audit Report for the previous year and the matters arising addressed?			
Proper bookkeeping	Is the cashbook maintained and up to date?			
	Is the cashbook arithmetically correct?			
	Is the cashbook regularly balanced?			
Standing Orders and Financial Regulations	Has the Council formally adopted Standing orders and Financial Regulations?			
	Has a Responsible Financial Officer been appointed?			
	Have items or services above a de minimis amount been competitively purchased?			
	Are payments in the cashbook supported by invoices and have they been authorised and minuted?			
	Has VAT on payments been identified, recorded and reclaimed?			
	Is Section 137 expenditure separately recorded and within statutory limits?			

1. Internal Control	2. Tests	3. Initial if Yes	4. Working Paper Reference	5. Comments
Risk Management Arrangements	Does a scan of the minutes identify any unusual activity?			
	Do the minutes record the Council carrying out an annual risk assessment?			
	Is insurance cover appropriate and adequate?			
	Are internal financial controls documented and regularly reviewed?			
Budgetary Controls	Has the Council prepared an annual budget in support of its precept?			
	Is actual expenditure against the budget regularly reported to Council?			
	Are there any significant unexplained variances from budget?			
Income Controls	Is income properly recorded and promptly banked?			
	Does the precept recorded in the cashbook agree to the District Council's notification?			
	Are security controls over cash adequate and effective?			
Petty Cash Procedures	Is all petty cash spent recorded and supported by VAT invoices/ receipts?			
	Is petty cash expenditure reported to Council?			

1. Internal Control	2. Tests	3. Initial if Yes	4. Working Paper Reference	5. Comments
	Is petty cash reimbursement carried out regularly?			
Payroll Controls	Do salaries paid agree to those approved by Council?			
	Are other payments to the Clerk reasonable and approved by Council?			
	Has PAYE/NIC been properly operated by the Council as an employer?			
Assets Controls	Does the Council keep an Assets Register of all material assets owned?			
	Is the Register up to date?			
Bank Reconciliation	Is there a bank reconciliation for each bank account?			
	Is the bank reconciliation carried out regularly on the receipt of statements?			
	Are there any unexplained balancing entries in any reconciliation?			
Year-End Procedures	Are year-end accounts prepared on the correct accounting basis?			
	Do accounts agree with the cashbook?			
	Is there an audit trail from underlying financial records to the accounts?			

1. Internal Control	2. Tests	3. Initial if Yes	4. Working Paper Reference	5. Comments
	Where appropriate, have debtors and creditors been properly recorded?			

## Appendix 5 – Good Practice – Action Plan

### Exhibit 12: Internal Audit Report 2017-18: Llysfaen Community Council

Issue	Recommendation	Follow Up
1	The bank reconciliation provided for audit does not state the bank balance as at 31/3/18 for the current account but instead states the reconciled balance with a nil balance for unpresented cheques.	The bank reconciliation should state the bank balance for the current account as at 31/3/18 as £5553.39 with unpresented cheques of £495.13. This does not affect the balance stated on the annual return which is correct.
2	[...]	[...]
<b>Follow up of 2016/17 audit recommendations</b>		
1	<p>The value of fixed assets has increased by £2273. This is partly due to the following:</p> <ul style="list-style-type: none"> <li>Mower added in at value of £1600, this is the purchase cost including VAT. Assets should be added in at the value net of VAT which would be £1333.</li> </ul> <p>We could not identify the remainder of the movement.</p>	<p>The asset register should be amended to include the mower at the cost of £1333.</p> <p>The annual return should be amended to show assets at £38,836.</p> <p>The Council should provide (within the explanation of variances for the external auditor), the reason for the movement in assets and ensure that it is only due to additions and disposals and does not include revaluations.</p>
2	[...]	[...]

## Appendix 6 – Good Practice – Audit Report

### Internal Audit Report 2017-18: Holyhead Town Council

#### 1. Purpose of the Audit

- 1.1 The purpose of the audit was to review the financial propriety and governance arrangements of the Council in accordance with proper practices as set out in the One Voice Wales/SLCC publication “Governance and accountability for local councils in Wales – A Practitioners’ Guide (as amended December 2014)”.

#### 2. Main Findings

- 2.1 The control objectives tested and proved to be satisfactory can be seen in Appendix A.

#### 3. Audit Opinion

- 3.1 Assurance can be expressed in the governance arrangements and the financial statement of Holyhead Town Council for the financial year 2017-18 based on the tests conducted, but there are aspects that could be tightened to mitigate the risks identified. It is recommended that the Council take appropriate steps to mitigate the following risks:

- Failure to ensure that Standing Orders and Financial Procedures are current.
- A number of cheques were pre-signed by one of the authorised signatories.
- Inadequate audit trail due to cheque stubs not being signed.
- Employees’ current remuneration and hours not documented in a contract.

#### 4. Acknowledgements

- 4.1 I would like to take this opportunity to thank the Deputy Clerk for all the help and co-operation with the completion of the audit.

Audit Manager

June 2018

## Appendix A – Control Objectives and Audit Findings

Appropriate books of account have been properly kept throughout the year.

- Cashbook maintained and up to date
- Cashbook arithmetically correct
- Cashbook regularly balanced

Financial Regulations have been met, payments were supported by invoices, expenditure was approved, and VAT was appropriately accounted for.

- Council has formally adopted standing orders, but there is no record that they are reviewed periodically.
- A Responsible Financial Officer has been appointed with specific duties
- Items or services above the “de minimis” amount have been competitively purchased
- Payments in the cashbook are supported by invoices, authorised and minuted
- VAT on payments have been identified, recorded and reclaimed
- The Council has approved and circulated to members its arrangements for making payments.
- S137 expenditure was separately recorded and within the statutory limits

The body assessed the significant risks to achieving its objectives and reviewed the adequacy of arrangements to manage these.

- Review of the minutes does not identify any unusual financial activity
- Minuted record that the council conducted an annual risk assessment
- Insurance cover is appropriate and adequate
- Internal financial controls are documented and regularly reviewed

The annual precept requirement resulted from an adequate budgetary process, progress against the budget was regularly monitored, and reserves were appropriate.

- The Council has prepared an annual budget in support of its precept
- Actual expenditure against the budget is regularly reported to the Council
- There are no significant unexplained variances from the budget

Expected income was fully received, based on correct prices, properly recorded and promptly banked, and VAT was appropriately accounted for.

- Income is properly recorded and banked promptly
- The precept recorded agrees to the Council Tax authority's notification
- Security controls over cash and near-cash are adequate and effective

Salaries to employees and allowances to members were paid in accordance with minuted approvals, and PAYE and NI requirements were properly applied.

- All employees have contracts of employment with clear terms and conditions. However, the contracts no longer reflect the current terms of employment
- Salaries paid agree with those approved by the Council
- Other payments to employees are reasonable and approved by the Council
- PAYE/NIC have been properly operated by the Council as an employer

The Asset register was complete, accurate, and properly maintained.

- The Council maintains a register of all material assets owned or in its care
- Asset register is up to date
- Asset insurance valuations agree with those in the asset register

Periodic and year-end bank account reconciliations were properly carried out.

- A bank reconciliation is prepared for each account
- Bank reconciliations are carried out regularly and in a timely fashion
- There are no unexplained balancing entries in any reconciliation

Accounting statements prepared during the year were prepared on the correct accounting basis, agreed with the cashbook, were supported by an adequate audit trail from underlying records, and where appropriate, debtors and creditors were properly recorded.

- Year-end accounts are prepared on the correct accounting basis
- Accounts agree with the cashbook
- There is an audit trail from underlying financial records to the accounts
- Debtors and creditors have been properly recorded

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