



# Middlewich Town Council

Review of Financial Systems and  
2018/19 Internal Audit

Clerk @ Middlewich Town Council  
JDH BUSINESS SERVICES LTD

## **Scope**

The council has requested that we undertake a wide ranging review of the council financial systems as well as an internal audit for 2018/19.

## **Work done**

- 1.) As requested we have carried out a 2018/19 internal audit based on the control objectives in the 2018/19 AGAR annual return.
- 2.) A wide-ranging review of council financial systems has been carried out covering the following key areas:
  - the accuracy and completeness of the financial statements submitted in 2018/19
  - the council's arrangements with respect to the Victoria Hall
  - the financial regulations
  - expenditure systems including authorisation protocols
  - VAT exempt, non-business and standard rated activity and returns
  - quotation/tendering procedures and compliance with the procurement requirements of the financial regulations
  - budgetary control reporting
  - council earmarked and general reserves
  - income systems and internal controls
  - payroll systems and internal controls
  - management of fixed assets

## **Summary of Results**

There are numerous financial internal control weaknesses at the council and the year end accounts as submitted for 2018/19 and 2017/18 to the external auditor and published are incorrect. None of the Victoria Hall income and expenditure transactions have been included in the 2018/19 year and accounts so the council accounts will need to be restated for 2017/18 and 2018/19 to include these transactions when compiling the 2019/20 AGAR annual return accounts. In addition, we identified examples of where net income is being included in the accounts instead of gross income and gross expenditure.

The Financial Regulations have not been updated for a significant period and contain no detailed compliance and authorisation controls for online banking even though that is the primary method by which council pays suppliers. With one exception, we could not identify compliance with the quotation/tendering requirements of the financial regulations so there are multiple breaches of the regulations with respect to the required procurement regulations of the council.

Capital expenditure had not been identified and updated into the fixed asset register and the fixed asset value disclosed in the AGAR accounts. Therefore, the fixed asset value is incorrectly stated. The current format and management of the asset register is not fit for purpose.

A number of the council bank accounts are not included in the RBS nominal ledger including the Markets PAYPAL account and all the Victoria Hall bank accounts covering hall hire and bar income. Therefore, the council receive no reports of the bank reconciliations, and income and expenditure, relating to these particular council services.

The risk assessment was not reviewed and updated in 2018/19 and the council was significantly underinsured in terms of fidelity insurance and money cover insurance. In addition, we could identify no risk based review and actions implemented in relation to compliance with the requirements of the GDPR.

General and earmarked reserves authorised by council are not input into the RBS nominal ledger so no expenditure against specific earmarked reserves is actually recorded and monitored. Therefore, there is no accurate record of the current actual level of earmarked reserves.

Income relating to business activity such as bar income, advertising income and market gazebo hire is significantly in excess of the threshold for registering for VAT but we could identify no internal review of whether VAT registration was needed and this needs urgent resolution. The council receives income relating to VAT exempt activity in the form of hall hire and the markets but there is no annual VAT partial exemption calculation carried out to evidence whether the council is below the partial exemption threshold of £7500 to enable the reclaim of input VAT related to VAT exempt service activity.

There were no written internal controls over the various income systems in place at the council such as hall hire, bar incomes, market incomes and a very limited audit trail for a number of the systems including bar takings. In addition, there is no evidence council approves all fees and charges annually. As a result of this income review a separate investigation is currently being undertaken with regard to a potential deficit in the Victoria hall bankings.

Payroll is being processed by a payroll agency but staff pay changes are notified by the RFO to the agency with no independent check by councillors on the scale rates actually paid. Expenditure is being paid out of bar cash receipts and not recorded in the ledger and this includes some bar staff who are not recorded on the council payroll.

The council has appointed a community mayor and deputy mayor including arrangements for reimbursement of expenses without first ensuring the arrangement is lawful. The council has not identified an available power to effectively appoint a non-member to civic office and the general power of competence does not appear to be an option. Recent advice received by the council from national associations indicates the community and deputy community mayor arrangement is unlawful.

## **Conclusion and Way Forward**

The issues and recommendations arising from our work in carrying out the internal audit for 2018/19 and the wide-ranging review of the council financial systems are reported in the action plan below, using the control headings from the AGAR annual return. This will enable council to identify clearly the areas where it is not meeting requirements and the action that is required to be implemented to help meet these financial control objectives in future.

All of these issues raised below were still internal control and financial system weaknesses in 2019/20 up to the date the review was carried out so the council will need to take account of all these issues when determining the responses to the governance questions in the Annual Governance Statement in the 2019/20 AGAR Annual Return. This is the form that is completed after the year end by Council and submitted to the external auditor and published.

**Our internal audit conclusion is that the council's system of internal controls is NOT currently in place, adequate for the purpose intended and effective. The council needs to take urgent and comprehensive action to rectify the financial control issues identified.**

	ISSUE	RECOMMENDATION	FOLLOW UP
<b>Use of council powers</b>			
	The council has appointed a community mayor and deputy community mayor including arrangements for reimbursement of expenses without first ensuring the arrangement is lawful. The council has not identified an available power to effectively appoint a non-member to civic office and the general power of competence does not appear to be an option. Guidance has been received from national bodies that indicates the arrangement, including the awarding of expenses, is unlawful.	<i>The council should review the guidance it has received from national bodies and urgently revisit the decision to appoint, and pay expenses to, a community and deputy community mayor.</i>	<i>The advice received from SLCC and NALC has been reviewed and the Community Mayor project has been ceased, following discussions with the Internal Committee and its chairman, given that it was ultra vires. The scheme has been ceased for the present time until a viable alternative option for a Middlewich Community Representative can be established.</i>
<b>AGAR internal control objective A – Appropriate Accounting Records kept throughout financial year</b>			
1	Although the RBS accounting ledger is the prime book of account for completely and accurately recording all council transactions, the following issues were identified: <ul style="list-style-type: none"> <li>the Victoria Hall banks accounts and associated income and expenditure transactions were not recorded in the ledger. This means that all the hall/room hire and the bar income transactions are not recorded nor any of the expenditure</li> </ul>	<i>All council income and expenditure transactions should be recorded in the RBS ledger and the associated bank accounts balanced monthly.</i>	<i>DCK Accountants have begun this process. Any transactions for Oct/Nov/Dec have now been entered on RBS. The January invoices will be entered using the new Purchase Ledger module, which will be used for all invoices moving forward. New cashbooks have been created for Paypal, Victoria Hall and Victoria Bar accounts, which will be used for all income and expenditure on these accounts moving forward. Monthly requisitions have been done for Oct/Nov/Dec and will be done at month end moving forward.</i>

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	<p>transactions.</p> <ul style="list-style-type: none"> <li>The transactions on the markets Paypal account are not recorded in the ledger</li> </ul>		
<b>AGAR internal control objective B – Compliance with Financial Regulations, payments supported by invoices, all expenditure approved and VAT appropriately accounted for</b>			
2	The current Financial Regulations (FRs) were adopted in 2004 and they contain no regulations that govern member authorisation requirements even though this is the primary method of paying suppliers	<i>The council should adopt NALC model Financial Regulations which have been aligned to the council scope and activity, including appropriate regulations for procurement and online banking.</i>	<i>The 2018 NALC Model financial regulations were adopted on 18<sup>th</sup> November 2019. Minor amendments are likely to reflect the process changes currently being developed.</i>
3	There is no evidence that all payments in excess of the £1000 threshold in the FRs for securing 3 quotations has been complied with. Some of the contracts are high value (eg Bare bones marketing) but there is no evidence of any procurement process and market testing. Therefore, the council has not complied with its Financial Regulations with regard to contract procurement.	<i>All contracts should be procured in accordance with the council Financial Regulations.</i>	<i>Some of the existing contracts don't comply with the current financial regulations but we are tied into them at present. All future contracts will comply with financial regulations and be checked and approved by the Clerk.</i>
4	Credit card payments are analysed separately on a spreadsheet but these do not form part of the expenditure/payments	<i>Financial Regulations must be adopted that also set internal controls over the use of the council Credit Card. These controls</i>	<i>Credit card controls are now contained within the financial regulations and have been implemented.</i>

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	pack that is reported to council regularly for approval. Therefore, there is no evidence that council are approving expenditure through the credit card. The controls over the use of a Credit Card are not included in the Financial Regulations	<i>should ensure there is a transaction limit placed on the card as well as a monthly and annual limit. All Credit Card payments should be approved by council.</i>	<i>The transactions have been reviewed and entered within RBS. A separate cashbook has been set up for Credit Card payments.</i>
<b>AGAR internal control objective C – Adequate Risk Assessment</b>			
5	We could not identify in the minutes or the information provided for internal audit any adopted comprehensive risk assessment for 2018/19 or 2019/20. This process was last carried out in March 2018.	<i>A comprehensive risk assessment should be established and then reviewed, updated and approved each financial year.</i>	
6	The Fidelity cover is currently £250k but cash and bank reserves are substantially higher. Fidelity insurance should cover the maximum projected cash and bank balances which is calculated as the year end cash and bank balances plus the next precept instalment.	<i>The council should estimate maximum projected cash and bank balances as part of annual risk assessment and set the level of fidelity insurance cover accordingly</i>	
8	Data protection risks:  There is no evidence that any action has been taken to ensure compliance with the	<i>The council need to urgently carry out a GDPR data audit and establish the required policies and procedures to help ensure compliance.</i>	<i>The Town Clerk has started this process has started and it is ongoing at present. Initial findings and changes required will be presented to the Internal Committee meeting in February.</i>

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	<p>GDPR, for instance:</p> <ul style="list-style-type: none"> <li>- We could not identify an external and internal privacy notice</li> <li>- No data protection policy has been adopted</li> <li>- No evidence that Subject Access Request and Data Breach procedures compliant with the GDPR had been adopted</li> <li>- No evidence data processing/sharing agreements have been established with relevant third parties</li> <li>- No evidence a document retention policy has been adopted</li> <li>- Personal data held at the offices is not locked securely</li> </ul>		<p><i>Personnel data is now being kept in a locked cabinet.</i></p>
<p><b>AGAR internal control objective D – Precept request resulted from adequate budgetary process, regular budgetary control and appropriate levels of reserves held</b></p>			
9	<p>The following budgetary control issues were identified:</p> <ul style="list-style-type: none"> <li>- The Fab Festival income and expenditure is material, however, the RBS ledger contains one line of budgetary reporting for the entire</li> </ul>	<p><i>Detailed income and expenditure codes should be established for the FAB festival to enable more detailed budgets to be set and monitored by council.</i></p>	<p><i>These have now been established and appeared as part of the new budget.</i></p> <p><i>Also separate categories and lines have been sent up for the FAB bar to ensure better analysis is available.</i></p>



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	<p>event.</p> <ul style="list-style-type: none"> <li>- The FAB budget is a net expenditure budget so separate income and expenditure is not monitored</li> <li>- Although budgetary control information is presented to council there is no description of variances even where there are material under/overspends eg £42500 PCSO underspend.</li> </ul>	<p><i>Budgetary control information presented to council should include an explanation of material budgetary variances</i></p>	<p><i>Material budgetary variances will be reported.</i></p>
10	<p>Budgetary Control – The Financial Regulations are outdated and as recommended in 2.) above up to date NALC model FRs should be adopted.</p>	<p><i>The updated Financial Regulations should include a requirement for budget monitoring reports to include written explanations by the clerk when variances are in excess of a level set by council.</i></p>	<p><i>Material budgetary variances will be reported. Financial regulation 4.8 includes this requirement.</i></p>
11	<p>General and earmarked reserves authorised by council are not being recorded in the RBS ledger so there is no reserve accounting carried out and therefore no record of expenditure against any of the earmarked reserves</p>	<p><i>The council need to identified all authorised earmarked reserves and these should be input into the RBS ledgers with any relevant expenditure against these reserves recorded so at the year-end an accurate record of remaining earmarked reserves is available.</i></p>	
<p><b>AGAR internal control objective E – Expected income fully received, correctly priced, recorded and promptly banked and VAT accounted for</b></p>			

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12	The council is not currently VAT registered, however, there are material outputs that would normally be standard rated such as the bar income from the Victoria Hall (which has not been recorded in the council ledger), bar income from the FAB event, advertising income from the FAB event and Gazebo hire for markets. However, there has been no review as to whether the council should be registered for VAT.	<i>The council should urgently write to HMRC and give details of the 2018/19 income types and ask whether they require VAT registration and when the date of registration should apply.</i>	<i>Advice has been received from Steve Parkinson and the Council will be writing to HMRC to request VAT registration.</i>
13	The council makes business, non-business and VAT exempt supplies. We understand the council currently reclaims input VAT on all supplies that relate to non-business and VAT exempt activity. However, according to VAT notice 749, the council can only claim input VAT on VAT exempt activity if the amount of VAT relating to exempt supplies is below the £7500 annual de minimis level. VAT notice 749 indicates that if this £7500 threshold is exceeded, then none of the VAT related to VAT exempt activity can be reclaimed for the financial year. A council should annually complete a calculation called a partial exemption calculation where there	<i>The council need to urgently secure the services of a VAT consultant that has experience in local authority VAT issues to complete partial exemption calculations including for previous periods in accordance with VAT time limit requirements.</i>  <i>The council should secure an understanding of VAT notice 749 and the partial exemption rules.</i>	<i>Steve Parkinson is currently carrying out this work for the Council.</i>

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	<p>is clear potential to exceed the £7500 limit for VAT inputs relating to exempt activity.</p> <p>The council currently has material VAT exempt activity eg hall/room hire for the Victoria Hall. No partial exemption calculation has been carried out to evidence whether the total VAT across all council activity and expenditure that is related to exempt activities for the year is in excess of £7500.</p> <p>If significant expenditure is planned in future for the Victoria hall, a major proportion of the activity at the hall would relate to hall/room hire which is an exempt VAT supply. As noted above if input VAT on exempt supplies exceeds the £7500 threshold no input VAT attributable to exempt activity can usually be reclaimed. Therefore. The council will need to assess the VAT implications of any significant expenditure in respect of the Victoria Hall and other council assets that provide VAT exempt services.</p>	<p><i>Prior to a decision to undertake any significant works to council assets the council should secure the services of a VAT adviser to provide guidance on the VAT impact of the various options available including the Option to Tax currently exempt activity.</i></p>	
14	<p>Income invoices and booking forms have no sequential referencing system and no sales ledger is used. A spreadsheet is maintained of paying in details.</p>	<p><i>A system of sequential invoice and booking form referencing is needed which can then be included on the paying in spreadsheet to</i></p>	<p><i>RBS Sales Ledger will be used for the creation of all invoices moving forward using sequential invoice numbering.</i></p>

	<b>ISSUE</b>	<b>RECOMMENDATION</b>	<b>FOLLOW UP</b>
		<i>help ensure all bookings are invoiced and all invoices are paid</i>	
15	There is no evidence that council approves all fees and charges for income annually	<i>The council should review and approve all fees and charges annually.</i>	<i>Hire charges for room hire in Victoria Buildings and Victoria Hall will be considered by the Internal Committee at their meeting in February.</i>
16	There were no written internal control procedures for the various income systems in place at the council such as hall hire, bar incomes, market incomes and there is a very limited audit trail for a number of the systems including bar takings.	<i>Robust internal control procedures need to be implemented for all income systems</i>	<i>These procedures are being developed for approval by Internal Committee. All income will be processed through RBS from Jan 2020.</i>
17	The FAB event provides tokens for cash payments to be used at the FAB bar but there is no system of sequential referencing of receipts for the tokens issued. Therefore, there is no system in place whereby the completeness and accuracy of FAB bar income can be checked by reconciling sequential receipts issued to total cash banked and recorded in the council ledger.	<i>Internal control procedures should be implemented that ensure the total income banked for the FAB bar can be checked to sequential receipts issued</i>	
18	Review of the Victoria Bar income records identified that some expenditure is being paid out of bar cash income. Although this is permissible as long as an expenditure invoice is secured, the accounts must	<i>Expenditure invoices should always be retained for expenditure paid for out of Victoria Bar cash incomes.</i>  <i>All income and expenditure should be reported gross in the council accounts.</i>	<i>Staff have been advised that all expenditure must be processed via RBS and the Council bank accounts and cannot be paid out of cash takings to ensure proper invoices and records are obtained.</i>

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	always be grossed up to ensure gross bar income and expenditure is reported.		
19	In some instance bar staff working at the Victoria Hall are being paid out of bar cash incomes but the staff are not included on the council payroll	<i>The council should review whether HMRC payroll requirements have been complied with for Victoria Hall bar staff.</i>  <i>All income and expenditure should be reported gross in the council accounts.</i>	<i>The payment of staff from bar takings have ceased. Staff must either be on the payroll (in the case of regular bar staff) or submit an invoice for payment as a contractor.</i>
20	The cooler hire for the Victoria Hall bar is a material ongoing spend but there is no evidence council has assessed the value for money of this option. There is no evidence that the contract for cooler hire has been market tested.	<i>The council should ensure the cooler contract is procured in accordance with the Financial Regulations, including reviewing the relative value for money of rent or buy options.</i>	<i>The Cooler contract has ceased and a new system has been installed at no cost to the Council provided by the beer supplier.</i>
22	Markets income is not recorded in the council accounts correctly. Currently the net movement on the Paypal account annually is posted to RBS ledger so the gross income and expenditure is not recorded.	<i>The markets income and expenditure transactions should be recorded in the RBS ledger</i>	<i>Separate cashbook being created within RBS for Paypal data with respect to the Markets to ensure proper income and expenditure records are available.</i>
<b>AGAR internal control objective G – Wages and salaries and members allowances paid in accordance with council approvals, and PAYE and NIC requirements properly applied</b>			
23	Payroll is currently being carried out by an agency. However, when a payroll change	<i>The council should introduce an internal control whereby any payroll change</i>	<i>Chairman and Chairman of Internal copied into all such Payroll changes. Payroll</i>

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	in made, for instance a % increase , a scale point change or a change in hours this is effected by staff with the agency with no check by council.	<i>notified to the payroll agency by the clerk is verified by the payroll agency with the Chair of the internal committee before any processing takes place.</i>	<i>company has been asked to ensure approval is provided by either chairman when such changes are requested by the Clerk.</i>
<b>AGAR internal control objective H – Asset and investment registers complete and accurate and properly maintained</b>			
24	Capital items identified during expenditure sample testing had not been updated into the asset register. Further review of the payments for the year identified that no capital items for 2018/19 or the 2019/20 financial year to date had been identified and updated into the FAR.	<i>The council should review capital payments in the expenditure analysis for 2018.29 and 2019/20 and update the fixed asset register accordingly. The updated 2018/29 Fixed asset value will need to be restated in the accounts section of the 2019/20 AGAR annual return.</i>	
25	<p>The asset register contains limited information to support effective management of the assets and accurate disclosures in the year end accounts:</p> <ul style="list-style-type: none"> <li>• date of acquisition is never recorded so it is impossible to match assets with financial year of purchase (and disposal)</li> <li>• The asset register does not appear to use historic cost value when assets are purchased, as required by the Practitioner’s guide</li> <li>• disposals are not evidenced</li> </ul>	<p><i>The fixed asset register should be formatted in a spreadsheet as noted.</i></p> <p><i>There should be a review of assets owned by the council to ensure they are recorded in the assert register. Items disposed of and obsolete items should be removed from the register at carrying value.</i></p> <p><i>The council should ensure all assets are covered in the insurance policy.</i></p>	

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	<ul style="list-style-type: none"> <li>• custodian of the asset is not stated</li> <li>• the location of the asset is not provided</li> <li>• as the asset register is in WORD format it cannot be automatically cast as in a spreadsheet.</li> </ul>		
<b>AGAR internal control objective I – Periodic and year end bank reconciliations were properly carried out</b>			
27	Bank reconciliations are carried out regularly using the RBS ledger system. However, the Victoria Hall bank accounts are not included in the RBS ledger, reconciled and reported to council. The Paypal account for market income and expenditure is not included in RBS and reconciled.	<i>All accounts must be accounted for in the RBS ledger, reconciled monthly, and reported to council.</i>	<i>All accounts are now incorporated into the RBS system and will be reconciled and reported on monthly.</i>
<b>AGAR internal control objective J – Accounting statements were prepared on correct accounting basis, agreed to cash book, and were supported by an adequate audit trail</b>			
28	<p>The 2018/19 accounting statements were not prepared correctly:</p> <ul style="list-style-type: none"> <li>• Victoria Hall accounts – the hall forms a part of the council but the income from hall hire and the bar sales, and hall expenditure including rates, have not been</li> </ul>	<i>The 2017/18 and 2018/19 accounts will need to be restated as noted and the restated accounts will need to be included in the comparatives for the 2019/20 AGAR annual return.</i>	<i>Revised accounts are being prepared by DCK Accountants for these periods to be submitted with the 2019/20 AGAR annual return.</i>

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	<p>included in the accounts of the council in the AGAR annual return. This means the council accounts have been materially misstated for 2017/18 and 2018/19.</p> <ul style="list-style-type: none"> <li>• There is evidence of cash expenditure paid for out of cash incomes for the Victoria Hall so adjustments will be required to gross up income and expenditure for the Hall</li> <li>• We understand the Paypal markets account is included as a one line entry in the financial statements instead of the respective detailed income and expenditure</li> </ul>		