

LONGSTANTON PARISH COUNCIL

REPORT IN THE PUBLIC INTEREST

Audit for the year ended 31 March 2012

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INTRODUCTION

1. Moore Stephens is the external auditor appointed by the Audit Commission to audit the accounts of Longstanton Parish Council (the Council) for the financial year ended 31 March 2012. We are required under section 8 of the Audit Commission Act 1998 (the 1998 Act) to consider whether, in the public interest, we should report on any matter coming to our attention for it to be considered by the Council or brought to the attention of the public. This report is made in discharge of that duty.
2. In submitting the 2012 Annual Return the Council and its Officers brought to our attention serious weaknesses in the required standard of governance.
3. This report considers three separate matters:
 - 3.1. the Council's decision to take on the management of a Sports and Social Club, known as The Pavilion, and its subsequent management;
 - 3.2. the Council's failure to check whether payments made to employees were due and supported by appropriate documentation; and
 - 3.3. the Council's failure to discharge its governance responsibilities as trustee of a charity.

CONCLUSIONS

4. In our opinion:
 - 4.1. by taking on the management of the sports and social club operated in The Pavilion:
 - 4.1.1. the Council did not consider the legality of certain transactions and consequently conducted activities that it was not legally empowered to conduct.
 - 4.1.2. the Council did not fully understand the employment situation it was entering into, and failed to assess risk properly despite having taken (and rejected) legal advice.
 - 4.1.3. the Council failed to comply with Value Added Tax legislation.
 - 4.2. In respect of the operation of The Pavilion and other matters: the Council failed in its duty to exercise proper stewardship of taxpayers' money, by failing to follow its own Financial Regulations and Standing Orders.
 - 4.3. In respect of the management of its finances, the Council failed to consider all relevant facts in setting its budget.
 - 4.4. In respect of its responsibilities as the sole trustee of a charity, the Council failed to submit information to the Charity Commission as required.

BACKGROUND

5. The Pavilion

- 5.1. The Council owns the building known as The Pavilion which provided facilities directly related to sports as well as a bar and a restaurant. The Pavilion had been run by a tenant, Longstanton Sports and Social Club (LSSC). The Council considered that the LSSC was not managing The Pavilion in a satisfactory manner or "in the best interests of and benefit to the community" and consequently, in March 2010, it made a decision to take over the management of The Pavilion. The transfer took place on 1 October 2010 and the Council continued to run the trading activities.
- 5.2. The Council made efforts to increase The Pavilion's level of trade by attracting custom from the temporary workforce that was engaged on the construction of the permanent way on the route of the Cambridge Guided Bus. A large

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- number of the workers were living in temporary accommodation near the main construction site which was located near The Pavilion.
- 5.3. The bar and restaurant activities ceased in August 2012 when the Council decided that the activity was no longer financially viable.
 - 5.4. When it decided to take on the management of The Pavilion in 2010, the Council took legal advice concerning the potential transfer of employment rights under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (“TUPE”). However, it rejected the advice that because the trade was being continued by the Council, TUPE applied and therefore the rights that the employees had accrued, whilst employed by LSSC, including those relating to redundancy payments, automatically became the responsibility of the Council. Some of those employees, who were given notice of termination of their employment, took their case for alleged unfair dismissal to an Employment Tribunal, which found in their favour, and against the Council. The total cost borne by the Council was £16,000 which included legal fees of £7,590.
 - 5.5. In order to make payments other than in cash, mostly for small fittings and consumables for The Pavilion, the Council authorised the issue and use of two preloaded bank charge cards. One was issued to an employee (£250) and the other to the Responsible Financial Officer (RFO) (£1,000) in their personal name. There was inadequate control over the custody of these cards. One of them was missing for a period of time. The Council has advised us that both cards have been cancelled.
 - 5.6. The RFO had expressed her concern that the financial information provided by The Pavilion’s management team was inadequate. The Council has subsequently identified potential discrepancies between recorded sales, and amounts banked. Draft accounts for the period 1 October 2010 to 31 August 2012 show income of £225,355.55 and expenditure of £259,392.85. This implies a loss for the period of £34,037.30.
 - 5.7. The Council’s internal auditor raised concerns in January 2011 and November 2011 about the legal requirement for the Council to register with H M Revenue & Customs (HMRC) for Value Added Tax (VAT), because the provision of bar and restaurant facilities is a business activity. The Council undertook to do this at its meeting on 7 February 2011 but failed to do so. The result of this failure to take the agreed action was that the Council did not correctly account for VAT on its bar and restaurant sales and purchases until it actually registered in September 2012. This also exposed the Council to a risk of being required to pay interest and penalties on its liability for VAT. Further, it resulted in the need to pay VAT amounting to £21,983.11, which had not been budgeted for, and for which it had inadequate reserves.

6. Validity of payments made to employees

In a separate matter, a monthly standing order had been set up in favour of a Council employee, as a payment on account of salary. This did not appear on the list of payments, which was presented for approval by the Council at its meetings. The individual’s full net pay was included in the list of payments for authorisation, and a payment of that amount was made, but without deduction for the amount paid by standing order. The Council therefore failed to check that these monthly payments continued to be due. As a consequence the Council suffered a loss of £15,000.

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7. Governance responsibilities as a charity trustee

The Council is the sole trustee for the charity “Allotments for public stone, gravel and clay pits” (registered charity no. 243965). The trustees of a registered charity are required to file with the Charity Commission the Annual Return (and the accounts, if necessary) within 10 months of the year end. The Council failed to file the 2012 Annual Return (and accounts, if required) by the statutory deadline of 31 January 2013. Paragraph 5 of the Charitable Scheme requires that “All proper accounts in relation to the Charity shall in each year be made out and certified in such manner as the Charity Commissioners require”. The Council has also failed to file the 2011 and 2012 Annual Return (and accounts, if necessary).

THE RESPONSIBILITIES OF THE COUNCIL

8. A Parish Council must act in accordance with the legislation which defines and restricts its powers to undertake transactions.
9. Regulation 4 (1) of The Accounts and Audit (England) Regulations 2011 makes a Council responsible for ensuring that the financial management of the Council is adequate and effective and that the Council has a sound system of internal control, which facilitates the effective exercise of the Council’s functions and which includes arrangements for the management of risk.
10. The Council is responsible for the use of funds raised by taxation. It is required to account to its Parishioners for the manner in which it has used and protected these funds.
11. Regulation 12 of the Accounts and Audit (England) Regulations 2011 requires a Council to prepare an Annual Return made up to 31 March in each year in accordance with proper practices. Proper practices are set out in Governance and Accountability in Local Councils – a Practitioners’ Guide (England) and require the council to give annual assurances concerning the quality of its governance arrangements including that it has:
 - a robust system of internal control to protect public funds;
 - adequately assessed the risks facing the Council and that it has taken the appropriate steps to mitigate those risks; and
 - disclosed everything it should have about its operations during the year including events taking place after the year end.

FINDINGS

12. Our findings relate to a number of aspects of the conduct of Longstanton Parish Council’s business, particularly:
 - the Council’s procedures for identifying the powers under which it can act;
 - the Council’s risk assessment process;
 - the Council’s budget setting procedures;
 - the Council’s procedures for maintaining an appropriate system of internal control over its activities;
 - the Council’s failure to follow its Financial Regulations; including (but not exclusively) regarding employment procedures;
 - the inadequacy of the accounting records;
 - the Council’s failure to comply with taxation legislation, and
 - the Council’s failure to properly discharge its governance responsibilities as the sole trustee of a registered charity

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13. The matters which we consider need to be brought to the attention of the public are set out below.

13.1. The Council's procedures for identifying the powers under which it can act

- 13.1.1. Before taking over the operation of The Pavilion the Council did not consider whether it had the legal powers to do so. Whilst the Council has a power to operate a community centre for athletic, social or recreational activities (section 19 Local Government (Miscellaneous Provisions) Act 1976), it does not have powers to operate a trading activity.
- 13.1.2. The Council did not follow its Standing Orders for adequate accounting records and systems of control, and the assessment and management of financial risks when deciding to manage The Pavilion and its business operations.
- 13.1.3. The Council was obliged to assume liabilities to employees in respect of accrued service under the TUPE regulations.
- 13.1.4. The assessment and management of risk for any new activity should include consideration at an early stage in the process of whether the Council had the legal powers to operate the bar and restaurant. The Council did not have these powers. Consequently it failed to follow its own Standing Orders and Financial Regulations which deal with this matter, when considering the legality of transactions which might have a financial consequence.

Conclusions:

The bar income of £204,168.24 and bar purchases of £105,044.86 relating to the trade of The Pavilion was unlawful. I have powers to apply to the Court for the costs of the activities described at 13.1.1 above to be declared unlawful. However, I do not consider that the associated further costs of doing so will bring any benefit to the parishioners because the activities have ceased and the membership of the Council has changed. The Council appointed a new client and Responsible Financial Officer and has introduced procedures to prevent a recurrence of the activities that I have described at 3.1 of paragraph 3.

13.2. The Council's risk assessment process

- 13.2.1. The Council did not accept legal advice that staff transferred to it from LSSC had accrued employment rights under the Transfer of Undertakings (Protection of Employment) Regulations 2006 ("TUPE"). As a consequence it incurred liabilities, which it had not budgeted for, amounting to £16,000.
- 13.2.2. The Council failed to assess the commercial risks associated with the operation of The Pavilion. It did not obtain accurate financial information on a timely basis, which would have enabled it to comprehend the risk and take action. As indicated in paragraph 5.6 the loss incurred by the Council was £34,037.30, which includes the VAT that was due of £21,983.11.

Conclusion: In failing to take into account factors that ought to have been taken into account in making the decision to take over the business of The Pavilion including a failure to act on legal advice the Council acted unreasonably and failed in its duty under Regulation 4(1) of the Accounts and Audit (England) Regulations 2011 to have adequate arrangements in place to manage risk.

13.3. The Council's budget setting procedures

- 13.3.1 The Council set its precept for 2011-12 without a proper assessment of the minimum level of reserves necessary in the light of the risks

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associated with the operation of The Pavilion. This exposed the Council to an increased risk of having insufficient funds available to meet the expenses of the Council as they fell due for payment.

- 13.3.2 At 31 March 2012 the Council had total reserves of £16,965; of this amount £9,672 was ear-marked for specific projects. The balance of reserves (£7,293) was therefore available as general working capital and as a contingency against risks. The amount of VAT due, before interest or penalties was subsequently calculated as £21,983.11. The Council therefore had made inadequate provision for its liabilities.

Conclusion: The Council did not set a budget after taking into account all relevant factors. This is a breach of section 50 Local Government Finance Act 1992.

13.4. The Council's procedures for applying an appropriate system of internal control over its activities

- 13.4.1. There were inadequate internal controls to ensure that The Pavilion's bar and restaurant sales were accurately recorded. There is no evidence of any scrutiny of the financial information for the Pavilion.
- 13.4.2. The Council could not locate one of the two preloaded cards issued to officers for emergency purchases, for a period of some months. This failure to keep safe custody over an item of value exposed the council to the risk of fraud or unauthorised expenditure.
- 13.4.3. The issue of preloaded cards may increase the risk that payments will not be properly authorised, as they only require one person to make a payment. They should only be used when there are adequate supporting controls.
- 13.4.4. The Council did not take sufficient care when reviewing the details of payments made to Council employees, and failed to confirm that all such payments were properly supported by appropriate documentation. As a result the Council authorised payments that had been improperly claimed.
- 13.4.5. Payments for bar and restaurant supplies were made in cash by the employees, who ran The Pavilion. There was no scrutiny or approval of such expenditure before it was made.
- 13.4.6. Payments were made by standing order without being checked to ensure they were for a valid purpose.

Conclusions:

1. The Council was in breach of its duty under Regulation 4(1) of the Accounts and Audit (England) Regulations 2011 to exercise a sound system of internal control over the pavilion and exposed itself to the increased risk of loss of public funds.
2. The Council was in breach of s150 (5) Local Government Act 1972 that requires that all orders for the payment of money are signed by two members of the Council.
3. The Council exposed itself to an increased risk of fraud and error as it did not have prior knowledge of payments that were made in its name.

14. The Council's failure to follow its Financial Regulations

The Council made payments to a brewery using cash received from bar sales.

Conclusion: The Council was in breach of its Financial Regulations which require that all receipts must be paid into the Council's bank account and all payments must be approved by a resolution of the Council.

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15. The quality of the accounting records

The Council has identified discrepancies between recorded sales and amounts banked. This also resulted in a mis-statement of the cash balances held by the Council.

Conclusions:

1. The Council was in breach of the requirement set out in regulation 5 of The Accounts and Audit Regulations (England) 2011, which requires accurate records to be maintained.
2. The financial records of the Council were inadequate as a basis for decision making, with the risk that incorrect decisions may have been made.

16. The Council's failure to comply with taxation legislation

16.1. Following a recommendation from its Internal Auditor, the Council undertook (at its meeting on 7 February 2011) to register for VAT. However, it failed to do so. The Council finally took steps to register for VAT purposes in September 2012.

16.2. The Council failed to register at the correct time and to submit VAT Returns and make payments as they fell due. As a consequence it now has a significant liability to HMRC and a further liability for any interest and penalties.

Conclusions:

1. The Council did not comply with s3 Value Added Tax Act 1994 in respect of the requirement to register as a taxable person at the appropriate time.
2. The Council did not account correctly for VAT on its bar and restaurant sales and purchases.

17. The Council's failure to comply with its obligations as a Trustee of a Registered Charity.

The Council failed in its governance responsibilities as the sole trustee of a registered charity. It failed to file the 2011 and 2012 Annual Return (and accounts, if required) with the Charity Commission by the statutory deadline for the registered charity for which it is the sole trustee: "Allotments for public stone, gravel and clay pits" (registered charity no. 243965). The Charity Commissioners have the right to strike off any Charity that fails to meet its reporting obligations with the resulting loss of any assets that are the property of the charity making the Council liable to an action for negligence. The Annual Returns for 2011 and 2012 were finally received by the Charity Commission on 18 September 2013.

Conclusion: The Council failed to discharge its responsibilities as a Charity Trustee.

18. Summary of losses

The matters referred to in this report have resulted in significant losses to the Council, which are made up as follows:

The Pavilion

Operating loss including VAT liability	£34,037.30
Redundancy payment and legal fees	<u>£16,000.00</u>
	£50,037.30

Other matters

Overpayment to Council employee	<u>£15,000.00</u>
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TOTAL	<u>£66,037.30</u>
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SUBSEQUENT ACTIONS

19. We note that the Council has already taken steps to deal with a number of the issues referred to in this report, including:
- 19.1. It ceased to operate the sports and social club, which had been located in The Pavilion, in August 2012.
 - 19.2. It has appointed a new Parish Clerk.
 - 19.3. It has registered for VAT as a consequence of its trading activities, and is in discussion with HMRC over the payment of the sum owing and any interest or penalty to be charged.

RECOMMENDATIONS

20. The Council must:

- 20.1. Undertake a comprehensive review of its procedures and prepare an action plan to ensure that it operates to a high standard of governance.
- 20.2. Follow Standing Orders and Financial Regulations in conducting its business.
- 20.3. Ensure that the legal powers on which the Council relies are considered when decisions are made.
- 20.4. Follow professional advice or undertake a proper risk assessment process before deciding not to follow the advice given, clearly recording its reasons for such action.
- 20.5. Promptly consider all audit reports and minute its response to all recommendations.
- 20.6. Carry out a critical review of the existing system of risk assessment and management and consider whether it is comprehensive and relevant (regulation 5(4)(a)(iii), The Accounts and Audit Regulations 2011) and make and implement the necessary changes if it is not.
- 20.7. Ensure that a proper budgeting process, reflecting the degree of risk to which the Council is exposed, is undertaken before the Council sets the precept for the forthcoming year.
- 20.8. Restore the Council's financial health by preparing budgets for a surplus at the year end, building reserves towards approved projects, as a contingency against risk and to accumulate the required level of working capital.
- 20.9. Deal with outstanding VAT issues as a matter of urgency and, if necessary, agree a schedule of payments with HM Revenue & Customs that will settle all outstanding liabilities within the cash flow resources of the Council.
- 20.10. Take all appropriate measures to obtain repayment of any amounts paid to employees, which it considers were outside the terms of the contracts of employment for those employees and take advice on whether it has a liability to PAYE and NIC, resulting from these payments.
- 20.11. Keep up to date the affairs of any registered charity for which it is the sole trustee, including filing all necessary documents with the Charity Commission.
- 20.12. Ensure that all Council staff and all Councillors are familiar with Financial Regulations and comply with them.

21. We also recommend that the Council should:-

- 21.1. Review its Standing Orders and Financial Regulations on an annual basis, record the results of the review and take action to deal with any perceived material weaknesses.
- 21.2. From time to time, consider those skills collectively required by the Council in the areas of financial reporting, risk assessment and internal control and provide such training as is considered necessary to discharge its duties properly in those areas (regulations 4(1) and 5 The Accounts and Audit Regulations (England) 2011).
- 21.3. In considering whether to follow professional advice once received, undertake a proper risk assessment process and clearly record the reasons for any decision taken.

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- 21.4. Instruct the Responsible Financial Officer to review the accounting systems, and the Internal Auditor to confirm the suitability of the systems.
- 21.5. Ensure that the adequacy of the system of internal control is considered at least annually by the Council and that any recommendations for improvement made by the Council's Internal Auditor are put in place as quickly as possible

Statutory procedure in connection with this Report

The Council must deal with this Report in accordance with the requirements of sections 10, 11 and 12, Audit Commission Act 1998, in particular, the recommendations in section 19 of this report must be discussed by the Council in a meeting that has been properly called and advertised.

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Appointed external auditor

30 September 2013