

Governance and Accountability for Local Councils

A Practitioners' Guide (England)

March 2014

Acknowledgements

The first edition of this guide was published in 2002 and was the result of work overseen by a project group with membership drawn from key stakeholders.

The Joint Practitioners' Advisory Group (JPAG) was originally formed in September 2002, with membership drawn from key stakeholders, to ensure that proper practices guidance remains relevant to the needs of users and is updated as appropriate.

Since 2005, the guide no longer applies to community councils in Wales which operate within a quite separate, albeit very similar, legal framework. We are grateful to colleagues from Wales who continue to participate in JPAG. The responsibility for producing guidance for community councils in Wales has now transferred to Wales where it is issued jointly by One Voice Wales (OVW) and the Society of Local Council Clerks (SLCC) following consultation with the Local Councils Audit Liaison Group of the Wales Audit Office (WAO).

In 2006, JPAG expanded to include key stakeholders representing other smaller bodies in England required to complete an annual return. Separate guides for Local Councils and Internal Drainage Boards (IDBs) are now issued by JPAG and published by the respective sector representative bodies.

In 2007, JPAG took on responsibility for delivering proper accounting practices guidance for larger bodies (with an annual turnover exceeding £1 Million) including IDBs.

In 2009, JPAG also became responsible for proper accounting practices for the largest local councils in England. The third edition of the guide presented for the first time accounting guidance for those bodies.

However, the change in the threshold defining 'larger' local bodies as those with annual turnover exceeding £6.5 Million introduced by the Accounts and Audit Regulations (England) 2011 requires a fresh approach to guidance for such bodies which is included in this 2014 edition of the guide.

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The contributions of the members of the group, and of those individuals who have contributed from time to time to the development of the guides are gratefully acknowledged. In particular, the first edition of this guide drew on and updated CIPFA's *Accounting Guidance Notes for Local Councils*, 1996 ('the purple book'). We are grateful to CIPFA for allowing this and for their continuing support.

In particular, JPAG would like to thank and pay tribute to the immeasurable contribution of Peter Lacey, who was the first sector chair of JPAG and whose vision still drives this group. RIP.

March 2014

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Preface

Good governance, accountability and transparency are essential to local councils and a cornerstone of the government's approach to improving public services.

Those who are responsible for the conduct of public business and for spending public money are accountable for ensuring that public business is conducted in accordance with the law and applicable proper practices. They must also ensure that public money is safeguarded, properly accounted for and used economically, efficiently and effectively.

In discharging this accountability, public bodies and those responsible for their management are required to make proper arrangements for the governance of their affairs and the stewardship of the resources in their care. They are required to report on these arrangements in their published Annual Governance Statement.

As a safeguard to the proper discharge of this accountability, external auditors in the public sector give an independent opinion on public bodies' financial statements. They may also review, and report on, aspects of public bodies' arrangements to ensure the proper conduct of their financial affairs, and those to manage their performance and use of resources.

This publication has been prepared in response to the need for a clear statement on 'proper practices' for both day-to-day practitioners - users and trainers alike - and auditors, internal and external. It is a guide to the accounting practices to be followed by local councils in England, and sets out the appropriate standard of financial reporting to be followed. It represents the 'proper practices' referred to in Accounts and Audit Regulations.

We are committed towards making this guidance as useful, complete and 'user friendly' as possible, but there will always be scope to improve. As it is our intention to issue updated versions of this guidance from time to time, there is a continuing opportunity to keep it up to date, identify and share good practice and respond to the needs of local councils. If you have comments or suggestions as to how to improve this guidance, please send these to 'Practitioners' Guide' at either NALC, 109 Great Russell Street, London WC1B 3LD or SLCC, 8, The Crescent, Taunton, Somerset TA1 4EA.

The public accountability framework

This guide maps out, in a practical way, the current requirements of legislation and the responsibilities of the various parties involved. It explains the processes that need to be carried out to comply with legal requirements and provides examples of how this may be achieved, building on the good practices currently being employed.

Basically stated, the accountability framework means that to inform their taxpayers, local councils with accounts must prepare a report on their activities for the year, which is externally audited and then published.

The approach relies to a significant extent on self-certification by councils that their internal arrangements are maintained at a level consistent with good practice. It requires the active participation of elected and appointed members in the process of providing positive assurance in public that their stewardship and governance of the publicly owned assets with which they have been entrusted has been properly managed.

Although councils have always provided some assurance to taxpayers through approving the annual accounts, members also need to provide a written annual governance statement. Councillors, working as a corporate body, need to be able to provide this assurance to stakeholders with confidence. The assurance must therefore be based on adequate information about the operation of internal controls within their councils.

To assist local councils in discharging these responsibilities in an efficient and comparable way, JPAG developed the annual return to which this guidance is addressed.

The accountability framework is 'risk-based'. It is proportionate to risk, to the amounts of public money involved and to stakeholders' need for assurance. While the limited assurance audit approach provides a lower level of assurance than that which preceded it, it remains responsive to the need to safeguard the proper conduct of public business.

External audit remains an essential element in accounting for public money. It makes an important contribution to the stewardship of public resources and to the corporate governance of public services. It also supports local democracy by helping to ensure that members and officers are accountable to the communities they serve and by providing assurance that the public money they manage has been properly spent.

The public accountability framework encourages openness and transparency from local councils by requiring that the annual return and external audit reports are made public. Councils should consider also making available internal audit and other third party reports to local taxpayers to demonstrate their commitment to inclusiveness, openness and transparency.

The public accountability framework

The framework does, however, recognise the higher risk to public funds within the largest local councils operating above an annual turnover threshold currently set at £6,500,000. Separate accounting proper practices and external audit arrangements are in place for these larger councils.

Introduction

The purpose of this guide is to help practitioners in local councils to understand the regulatory environment in which they work. It provides information about the accountability framework and looks at how risk management, sound internal control and the roles of the internal and external audit apply to local councils. The aim is to provide a practical source of proper practices in accounting, governance and internal control applied by local councils to meet their responsibilities. The guide is designed to be helpful not only to practitioners, but also to elected members, council officers, accountants, internal audits and trainers.

Most local councils meet their public accountability and reporting duties by completing a single document, the annual return, which is issued each year by JPAG. The annual return balances the need for transparency and openness with the need to minimise the burden of public reporting for small public bodies. It is designed to inform local taxpayers and other key stakeholders about the work and finances of their local council in an accessible way while still meeting public reporting standards.

The accountability framework applies to all local councils with either annual expenditure or annual income up to £6,500,000. Local councils operating above this threshold, and those electing to report as larger bodies, are subject to a more stringent accounting requirement which is described in Part 4 of this guide.

The guide is structured as follows:

- **Part one** covers the legal framework within which local councils and their auditors must work. This is supported by Appendix 1 which summarises local council services and their legal powers.
- **Part two** provides guidance on completing the annual return. This takes practitioners through each of the sections of the annual return and provides guidance on good practices.
- **Part three** focuses on accounting guidance, describing in more detail proper practice when preparing the accounting statements.
- **Part four** directs local councils operating above the £6.5 million threshold and those below the threshold electing to account as if they were a large authority to applicable proper accounting practices.
- **Appendices** provide additional information and tools for practitioners.
- A **glossary** of words and phrases commonly used is included at the end of this guidance.

For the avoidance of doubt, parts two to four of this guidance, including any relevant appendices referred to in those parts, contain the proper practices within the meaning of the Accounts and Audit Regulations in relation to the accounts, governance and internal controls at local councils in England.

Introduction

Regulations require that small bodies must prepare for each year an income and expenditure account and a statement of balances in accordance with, and in the form specified in any Annual Return required by, proper practices in relation to accounts.

Within these proper practices:

- The word '**must**' means there is a specific legal or regulatory requirement affecting local councils. To assist practitioners those sections that contain a legal or regulatory requirement are presented in bold type. '**Must**' is a requirement that is essential and auditors will report compliance failures.
- The word 'should' identifies guidance that represents minimum good practice but for which there is no specific legal requirement. Councils follow this practice unless there is a good reason not to. Examples of this would include the council's Standing Orders and non-contract related Financial Regulations.
- The word 'may' identifies those proper practices where the council may apply discretion.

This document is intended to be a working tool for local councils. It is not a comprehensive guide to all aspects of local government law applicable to local councils, nor can it answer all queries about the application of the accountability framework as this develops over time.

Arrangements have, therefore, been put in place to provide local councils with technical support through the respective county and regional structures of NALC and SLCC. They are supported by regular meetings of JPAG. These arrangements are intended to provide sources of further support and guidance, and, from time to time, the guidance in this document will be updated and revised as appropriate.

For a detailed summary of the rights of individuals in relation to the accounts of local councils please see the Audit Commission's publication – *Council accounts: a guide to your rights*. Those viewing this guidance electronically may access the publication via the following web link: [Council accounts: a guide to your rights](http://www.audit-commission.gov.uk/about-us/contact-us/querying-council-accounts/council-accounts-a-guide-to-your-rights/)¹

¹ The web address is <http://www.audit-commission.gov.uk/about-us/contact-us/querying-council-accounts/council-accounts-a-guide-to-your-rights/>

Part 1 - The legal framework for local councils in England

This part of the guidance describes the nature of local councils and the legal framework within which they operate. It also covers the development of the annual return approach to statutory reporting and the supporting audit process.

What are local councils?

- 1.1 For the purposes of this guidance, the general term local council refers to a number of bodies which have roles in the administration of community affairs. These include parish councils, town councils and parish meetings (in parishes where there is no parish council). This guidance also applies to joint committees of local councils and to Charter Trustees. The roles of all these bodies are similar and there is a commonality of stakeholders in the local areas served by these bodies. It is appropriate, therefore, that a common accounting, audit and public reporting framework apply to them all.
- 1.2 Local councils are local government bodies, and can only do that which they are empowered to do by law. Anything else, no matter how apparently justifiable or useful, will be beyond the powers of the council ('ultra vires').
- 1.3 From 2008, local councils may select additional alternative styles, choosing from the names *Community*, *Neighbourhood* or *Village* as well as *Parish*. The adoption of an alternative style does not, however, have any effect on legal powers or affect formal reporting duties.

Parish Councils

- 1.4 Parish councils are the most common type of local council. They were constituted by the Local Government Act 1894 taking on powers and duties which, until then, had been administered by churchwardens and overseers of the poor. The current powers and duties of parish councils are derived from various parts of legislation. Appendix 1 provides a short summary of the main local council services and powers.
- 1.5 Parish councils exist to consider community affairs and exercise the powers bestowed on them. The council itself is made up of councillors who are either elected by local residents or selected to fill vacancies. Each local council has a clerk who acts as the chief officer and is the council's *Proper Officer*. Depending on size, local councils may employ a number of additional staff.

Part 1 - The legal framework for local councils in England

- 1.6 For most parish councils, the majority of income is derived from the precept, which is an annual charge on local taxpayers. The precept is set each year by a parish council as part of its annual budgeting process and is collected on the parish council's behalf by the local authority responsible for collecting council tax for its area. The level of precept depends on the nature and scope of the parish council's activities.
- 1.7 There are other resources available to parish councils in addition to the precept. Many parishes receive interest on bank balances, grants and income from charges for the use of their facilities (through, for example, hall hire charges, burial fees, sports facility rents, car parks etc.) and in some cases from returns on investments.

Town and City Councils

- 1.8 In some areas the parish council is known as the Town Council or, sometimes, the City Council. As they often cover a larger population than many rural parishes, town and city councils tend to have larger precepts and provide a wider range of services.

Local Government and Public Involvement in Health Act 2007

- 1.9 Part 4 of this Act introduced new powers for parishes including:
- alternative styles of name such as community, village or neighbourhood council;
 - appointing councillors²;
 - community strategies and governance reviews; and
 - extension of powers of wellbeing.

Charter Trustees

- 1.10 Charter Trustees are found in large towns. They were established following local government reorganisation in 1974 where former cities and boroughs became part of district councils but did not become parish councils and following subsequent local government reorganisations. The powers and duties of Charter Trustees are contained in the Charter Trustee Regulations 1996 (as amended). These include electing a mayor, owning and maintaining ceremonial property and making and receiving official visits to or on behalf of the town. The Charter Trustees may set a precept to cover their expenses.

² The power to appoint councillors has not yet been commenced

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Parish meetings

- 1.11 Parish meetings differ from parish councils in that they are not corporate bodies. They exist to discuss the affairs of the local community but do not have the full range of powers of parish councils except where express powers enable them to exercise certain functions. Where there is no parish council the parish meeting has statutory powers to provide and maintain:
- allotments;
 - burial grounds;
 - closed churchyards; and
 - footway lighting.
- 1.12 The governing law applies equally to parish meetings, and their chairs are accountable to local electors. This proper practice guide applies, therefore, equally to parish meetings as it does to parish and town councils and their joint committees. **Each local council and parish meeting where there is no council, must, irrespective of size, prepare accounts annually in the format specified in the annual return and have the accounts audited.**
- 1.13 A number of parish meetings and a few parish councils frequently incur no financial transactions in a financial year. **Local councils with no financial transactions do not prepare accounts but must instead complete a 'Declaration of no accounts' for each relevant year.** Local councils should display the declaration publicly and prominently and send a copy to their appointed auditor on receipt of notification of annual audit. A pro forma copy of the declaration for local use may be found at Appendix 11 or downloaded from the Audit Commission website.
- 1.14 For parish meetings the chair and proper officer of the local council tax authority are jointly a body corporate known as the *Parish Trustees*³.

Joint committees

- 1.15 Schedule 2 of the Audit Commission Act 1998 requires that 'a joint committee of two or more (local) authorities' shall maintain accounts which are subject to annual audit. Such joint committees will have an external auditor appointed by the Audit Commission and, although they are not independent legal entities, for the purposes of keeping accounts and submitting to audit, they are separately subject to the same rules and regulations as other local councils.
- 1.16 The management of joint committees is usually located with one of the participating councils known as the 'lead' council. The lead council is responsible for meeting the accounting and reporting responsibilities of the joint committee although all participants should approve the arrangements.

³ S 13(3) Local Government Act 1972

Councils' accounts and audit arrangements

- 1.17 Two pieces of legislation set out how local councils should behave when accounting for the public funds they manage and what rights local taxpayers have in relation to those accounts. These are the Audit Commission Act 1998 and the Accounts and Audit Regulations issued from time to time under the Act.
- 1.18 The requirement for local councils to prepare accounts annually and to subject them to external audit comes from the Audit Commission Act 1998 (the Act). The Act describes the rights of taxpayers and other interested parties in relation to those accounts.
- 1.19 The Act also provides that the Secretary of State may make regulations covering:
- how accounts should be kept;
 - the form of accounts and how and when they must be approved and published;
 - where and for how long taxpayers can view the accounts and the details behind them; and
 - how taxpayers exercise their rights in relation to the accounts⁴.
- 1.20 This guide provides access to a current copy of the Accounts and Audit (England) Regulations 2011 (the Regulations) for use as a reference tool for practitioners at Appendix 7. Practitioners should make sure that they are always viewing the latest version of the Regulations when considering how they should be applied.
- 1.21 Practitioners should note Royal Assent was granted to the Local Audit and Accountability Act 2014 ('the new Act') in January 2014. This Act repeals much of the Audit Commission Act 1998 and provides for the closure of the Audit Commission on 31 March 2015. Subject to commencement orders and supporting regulations the new Act will eventually become the statutory accounting and audit framework for small bodies in England. This guide will be updated as the Government introduces new regulations to implement the new Act.

Roles and responsibilities within local councils

- 1.22 Local councillors are elected every four years in local elections, the whole council retiring at the same time. A chairman or town mayor is elected annually by the council from among its members. From time to time councillor vacancies occur which may be filled following a by-election or by co-option or by appointment. While the status of co-opted and appointed members is marginally different in law, all members have the same duties and responsibilities in relation to a local council's governance and accountability.

⁴ See Introduction section above for a link to detailed guidance on electors' rights

Part 1 - The legal framework for local councils in England

- 1.23 **Parish affairs are discussed at council meetings that must convene at least three times a year in addition to the annual council meeting.** In most parishes meetings are held on a monthly basis and local electors may attend to observe the proceedings.
- 1.24 Most local councils (although few parish meetings) employ a clerk to oversee the administration of its affairs. **Parish councils are required by section 151 of the Local Government Act 1972 to appoint an RFO to manage their financial affairs.** In many instances the clerk also holds the post of RFO. Larger parishes may also have other employees such as administrative assistants and grounds staff. As an employer, the council has the same duties and responsibilities, including the operation of PAYE, as any other employer. HMRC have confirmed that it is not possible for office holders in local councils, including the office of clerk, to be self-employed.
- 1.25 If no RFO has been appointed, the person responsible for the administration of the financial affairs of a local council or, if no person is so responsible, the person who is responsible for keeping the accounts of the council is deemed to be the RFO.
- 1.26 It is the council as a whole, however, that is responsible in law for ensuring that its financial management is adequate and effective and that the council has a sound system of internal control which facilitates the effective exercise of their functions and which includes arrangements for the management of risk.
- 1.27 **Under the regulations, all local councils must at least once a year conduct in accordance with proper practices a review of the effectiveness of their system of internal control and publicly report the outcome.** The Annual Governance Statement in Section 2 of the annual return provides the means for local councils to report to local taxpayers on their system of internal control.
- 1.28 Practitioners may wish to refer to a helpful booklet produced by the Audit Commission entitled *Statement of responsibilities of auditors and of small audited bodies* which describes the relationship between local councils and their external auditors. It seeks to clarify where the different responsibilities of the local council and its auditor begin and end. The statement is reproduced at Appendix 2.

The Audit Commission and the development of the limited assurance audit approach and the annual return

- 1.29 A key feature of the audit approach, which first came into effect for financial years ending on or after 31 March 2002, is that it recognises the differing circumstances of local councils of different size. This is described in the flowchart at Appendix 3.
- 1.30 This guide focuses primarily on the needs of practitioners within local councils. However, the following paragraphs may be helpful as background to the development of the audit approach. For complete transparency, relevant extracts from the Audit Commission's Code of Audit Practice can be found at Appendix 4. The Commission's standing guidance to external auditors of small bodies is reproduced at Appendix 5.

Part 1 - The legal framework for local councils in England

- 1.31 The Audit Commission is an independent body with statutory responsibilities to regulate the audit of local government in England. The Commission's Code of Audit Practice - Local Government (2010) ('the Code') sets the required standards for its appointed auditors. The Code, when talking about how auditors discharge their statutory audit duties at local councils, states:

'S1.2 It is the responsibility of small bodies to put in place proper arrangements to ensure the proper conduct of their financial affairs, and to monitor the adequacy and effectiveness of those arrangements in practice. Small bodies are required to prepare their accounts in accordance with their statutory responsibilities, and to maintain an adequate system of internal audit of their accounting records and control systems.'

S1.3 Small bodies meet their responsibilities by preparing and publishing, and providing the auditor with, the accounts prepared for the financial year, together with such additional information and explanation as is necessary to provide sufficient evidence that they have maintained adequate systems of internal control and internal audit throughout the financial year.'

- 1.32 Working with the Commission, the representative bodies for local councils and their clerks, responsible government departments and the public sector accounting professional body, CIPFA, undertook to develop a simple approach to meeting this legal responsibility which is:
- easy to prepare and may be easily understood by readers;
 - subjected to an appropriate level of external audit without the need for lengthy preparation and inconvenience; and
 - cost efficient.
- 1.33 The outcome was the annual return, a sample copy of which is attached as Appendix 6. **For accounting years ending 31 March 2006 and thereafter, completion of the annual return by local councils where annual income or expenditure is £6,500,000 or less is a requirement of the Accounts and Audit Regulations.**
- 1.34 Part 2 of this guide considers the annual return in more detail, but some general points about this approach should be noted.
- 1.35 The external audit approach described above relies heavily on the co-operation of the council with the external auditor and on a significant amount of self-certification by the council. **Corporate governance arrangements within the council must be demonstrably sound.** For this reason, auditors are entitled to expect the annual return or declaration to be accurate and complete when presented for audit. **The annual return must be prepared in accordance with the proper practices in this guide.**

Part 1 - The legal framework for local councils in England

- 1.36 Since 2010, JPAG has taken over the responsibility to issue the form of the annual return each year. These proper practices provide the necessary guidance to assist practitioners to complete the annual return.

‘Proper practices’

- 1.37 The Accounts and Audit Regulations refer, in a number of places, to the need for local councils, in fulfilling the requirements of the Regulations, to follow ‘proper practices’.
- 1.38 In the Circular which accompanies the revised 2006 Accounts and Audit Regulations for England⁵, DCLG explains the source of the term ‘proper practices’, their legal standing and where they may be found. The DCLG guidance confirms that for local councils it is this publication, Governance and Accountability in Local Councils in England and Wales – a Practitioners’ Guide⁶, in which the proper practices in relation to the accounts, governance and internal controls may be found.

The council as trustee

- 1.39 Certain local authorities have powers to be appointed as trustee of local, usually charitable, trusts and fulfil this role as either custodian or management trustee.
- 1.40 Charitable trusts in England are regulated by the Charity Commission which sets out minimum standards of accounting and audit requirements where these are not covered by the Trust Deed. The Charity Commission also requires annual reporting by registered charities.
- 1.41 In cases where local authorities are sole managing trustees (i.e. hold legal title to and manage the property and/or investments of the trust) the accounts of the trust are a separate account of the local authority and, therefore, subject to disclosure and audit. This requirement is in addition to any reporting or audit required by Charity law.
- 1.42 Larger authorities meet this requirement via disclosure in the notes to the accounts which are covered by an audit opinion. For smaller bodies preparing an annual return there are no provisions for notes and so the required disclosure is achieved through a simple disclosure in the annual return.
- 1.43 Section 1 of the annual return (the accounting statements) requires the council to disclose whether it acts as sole trustee and is responsible for managing trust funds or assets.
- 1.44 **If the council has disclosed that it is a sole managing trustee it must also complete the associated assertion in the annual governance statement.** In this way, small bodies meet the legal requirement to disclose each ‘account of the body’. Auditors plan work around these disclosures, as required.

⁵ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/8309/1177532.pdf

⁶ As amended and any successor publications

Part 1 - The legal framework for local councils in England

- 1.45 There is no requirement for local councils to prepare consolidated or group accounts. **Councils must not include the charitable trust funds in the accounting statements within the annual return.**
- 1.46 Councils should ensure that a separate bank account operates to receive income for each trust to which it is a custodian or managing trustee. If, exceptionally, the council's bank account is used to receive monies intended for the trust or to pay for any expenditure on behalf of a trust (prior to recovery from the trust account), then it is correct to include these transactions, including any VAT, in the annual return of the council as being its own expenditure and income during the year. This exception applies only to the extent that the income or expenditure made on behalf of the trust is yet to be recovered or paid over and is included in the council's accounting statements as debtor and creditor amounts. However, to simplify accounting and ensure separation, a separate bank account should be established for any trust as soon as possible and that funds are never or only exceptionally mixed. The reserves of the council should not include those belonging to any trust.
- 1.47 **Meetings of the council when it is acting as charity trustee must take place separately from those of the council acting as the council. Separate minutes must be kept.** In order to avoid confusion, trust business should always be minuted separately from council business. Separate notices and agendas for meetings should be issued.
- 1.48 The clerk should take responsibility for guiding the council regarding the capacity, either as the council or as trustees for a charity, in which members are meeting. The chairman should make clear to the meeting, at the outset and throughout, the capacity in which it is meeting, particularly if council and trust meetings are held one after the other, or where confusion around capacity is possible.
- 1.49 **The value of trust property must not be shown in the council's books of account and on the annual return as council property.** Trust assets held by the council as custodian or managing trustee should, however, be recorded in the council's asset register and identified there as 'charity assets held by the council as trustee' with their value excluded from the total.

Part 2 - The annual return and corporate governance

This part looks at the annual return in more detail to provide practitioners with guidance on completing the annual return and submitting it for audit. Part 2 also explains how councils address risk management, internal controls and the role of internal audit. Understanding these, and how they work together, is key to good governance and proper accountability.

Part 2 of the guidance is structured as follows.

- What is the annual return?
- The accounting statements (Section 1 of the annual return).
- Explaining significant variances and analytical review.
- Bank reconciliation in support of the annual return.
- Some notes about investments.
- The annual governance statement (Section 2 of the annual return).
- The external auditor's certificate and opinion (Section 3 of the annual return).
- Internal audit's annual report (Section 4 of the annual return).
- The review of the system of internal audit.
- Risk management.

What is the annual return?

2.1 The annual return (see Appendix 6) is a document that has several purposes:

- to report the annual accounting statements approved by the council;
- to certify that the council has discharged its statutory duties in relation to its financial affairs;
- to record that the external auditor has fulfilled their statutory responsibility;
- to inform the local taxpayer and elector about what and how their council has been doing during the last financial year; and
- to be a source of information for government and other stakeholders about the activity of local councils.

Part 2 - The annual return and corporate governance

2.2 The annual return comprises four linked sections:

- Section 1 - the accounting statements;
- Section 2 - the annual governance statement;
- Section 3 - the external auditor's certificate and opinion; and
- Section 4 - the report from internal audit.

2.3 The first three of these sections are intended to be displayed to the public. The annual return has been designed so that when it has been signed by the auditor and returned to the local council, the three key sections (1 to 3) can be viewed together and easily displayed on most notice boards.

The accounting statements (Section 1 of the annual return)

2.4 **Each local council is required by section 151 of the Local Government Act 1972 to appoint an RFO as the person responsible for the administration of its financial affairs⁷. Part 1 of the annual return is the local council's statutory annual accounting statement. It must be signed by the RFO to certify that it presents fairly the financial position of the council at the end of the year to which it relates and its income and expenditure, or that it properly presents receipts and payments, as the case may be (see also paragraph 2.7 below), and that it is consistent with the council's underlying financial records. The Council must also disclose here if it is a sole managing trustee (see paragraphs 1.39 to 1.49).**

2.5 By signing the certificate, the council's RFO reports being satisfied, and can, if requested, demonstrate, that the accounting procedures, which have been determined by the RFO on behalf of the council, have been observed throughout the year and that the supporting financial records of the council are maintained in accordance with proper practices and kept up to date. **The signature must be that of the RFO at the time of approval.**

2.6 **Current rules require local councils where the gross income or expenditure for the year (whichever is the higher) has exceeded the threshold of £200,000 for a period of three continuous years, to report their financial details on an income and expenditure basis, from the third year onwards.** In Part 3 of this guide, detailed guidance is given, together with examples, about what needs to be done at the year-end to convert a receipts and payments account into an income and expenditure account. This guidance is found in paragraphs 3.82 to 3.88 below. Local councils operating below the £200,000 threshold have the option to report either on an income and expenditure basis or on a receipts and payments basis.

⁷ See paragraph 1.25 for guidance on how to determine who is responsible for administering the council's financial affairs if no formal RFO appointment has been made

Part 2 - The annual return and corporate governance

- 2.7 **However, councils that change the basis on which their accounts are presented must ensure that the comparative year's accounts in the annual return are shown on a consistent basis. Any change in the way that the accounts are presented, i.e. from income and expenditure to receipts and payments (or vice versa) must be reported on the annual return by adding the word 'RESTATED' at the top of the prior year column in section 1, and explained by means of a note to the auditor.**
- 2.8 **The council is required to give a public assurance (see paragraph 2.42) that in approving the annual accounting statements it is satisfied that they have been prepared in accordance with the requirements of the Regulations and proper practices.** As with other decisions made by the council, all of which have a legal implication, councillors have a duty to make themselves familiar with the requirements contained in the Regulations as they are jointly and severally legally responsible.
- 2.9 **Alongside the RFO's certificate, the person presiding at the committee or meeting at which the approval is given must confirm, by signing the statement at the bottom of section 1 of the annual return, that the accounting statements have been approved by the council in accordance with the Regulations. The Regulations require the accounting statements to be approved as soon as reasonably practical and in any event within three months after the end of the period to which the accounting statements relate.** The intention behind the additional requirement for the chair of the committee or meeting to sign and date the accounting statements is that the chair's signature formally confirms the legal completion of the council's approval process for the accounts.
- 2.10 **In practical terms, as the financial year-end for local councils is 31 March in any year, the annual return must be approved by 30 June.** However, the further the distance between the year end and the approval and publication date, the less useful the accounting statements and annual governance statement are to the reader. The statutory approval date should be viewed, therefore, only as the latest possible date by which the approval can be given rather than a target date. It is good practice to complete the annual return and have it approved and published by the council as close as possible to the financial year end to which it relates.
- 2.11 Section 1 of the annual return standardises the presentation of a local council's accounting statements into a simple and easy to read format. For the benefit of both the compiler and the reader, each of the 11 numbered items carries a note of explanation about the intended source of information and an explanation of how the figure is calculated.
- 2.12 **All boxes of the annual return must be completed, including writing 'nil' or '0' in any box that does not appear to apply.** Leaving blank spaces only leads to questions by readers who may not be sure if the compiler intended a nil balance or whether an omission or error has occurred. Auditors are required to eliminate such uncertainty and it is likely that any unexplained omissions will lead to additional, avoidable correspondence with the council for which additional fees may be charged.

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- 2.13 **All figures in Section 1 of annual return must agree to the council's primary accounting records.** The RFO should be able to show how the figures in the annual return reconcile to those in the cashbook and other primary accounting records. Members should expect to see this reconciliation when they are asked to approve the accounts in the annual return. Local taxpayers inspecting the accounts have legal rights to ask to see the detail making up the amounts in any of the boxes in Section 1 and for sight of the supporting documents.
- 2.14 More detailed accounting guidance to support completion of the annual return is provided in Part 3.

Explaining significant variances and analytical review

- 2.15 **Auditors will always request and councils must provide an explanation of significant variances in annual levels of expenditure and balances in Part 1 of the annual return.**
- 2.16 The purpose of showing comparative values in financial statements is so that the reader can observe and note any changes in levels of activity from one year to the next. The absence of significant variances from one year to the next implies that the council has continued to provide expected services at the same level and approximately at the same cost as previously. Readers are, therefore, drawn to any items which are significantly different or unusual, as representing a possible change in the scope or level or cost of services they have come to expect.
- 2.17 The external auditor, acting as the public watchdog, asks the question about significant or unexpected changes in the accounts on behalf of local taxpayers and is looking for a sufficiently detailed and meaningful analysis and explanation from the council of the reasons for change.
- 2.18 It is also good practice for local councils to incorporate an analytical review into their regular budget monitoring procedures to probe the underlying reasons for variations in expected income or expenditure. This helps to ensure that members of the council understand fully the pattern of income and expenditure flows during the year and informs their decision making.
- 2.19 Analytical review may be carried out in a number of ways and leads to an understanding of:
- variations in income or expenditure (or receipts and payments) from year to year;
 - variations between actual figures and budgeted income and expenditure (or receipts and payments); and
 - the relationships between various figures or line items in the same set of accounts.

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- 2.20 For example, an unexplained increase in precept (Box 2) of say 20 per cent which is not matched by a corresponding increase in expenditure requires an explanation. Conversely, a 50 per cent rise in annual precept with a corresponding increase in balances (Box 7) that is explained as being, say, the first of a number of budgeted annual contributions to an earmarked reserve for the planned rebuilding of a village hall, may well be accepted by the auditor as being reasonable and requiring no further action.
- 2.21 Similarly, an increase in borrowing (Box 10) without an equivalent increase in capital spending (Box 6) and in the value of fixed assets (Box 9) would raise a question. The answer may well be that the timing of the borrowing and the expenditure fell in different financial years, but an explanation is required nonetheless.
- 2.22 The question ‘what is ‘significant?’ is often asked. Any change (or even the absence of change when one might be expected – as in the above example of a precept increase not matched by expenditure) can be significant and the RFO should be prepared to explain any figure presented in the accounts. However, as a general ‘rule of thumb’ and given that the figures in section 1 of the annual return are aggregates rather than specific expenditure items, changes (either up or down) of 10 to 15 per cent and greater will almost certainly require a formal explanation. External auditors may state a percentage figure in their letter calling the audit. This figure should be followed and a full explanation of the variance provided
- 2.23 Balances that move to or from zero will also generally require an explanation. As most expenditure by local councils comes from the provision of statutory (rather than voluntary) services, the sudden absence or appearance of an expenditure category implies a change in service provision.
- 2.24 **Where the value in Section 1 Box 7 does not equal Box 8, this difference must be explained.** This difference should only occur in cases where the council’s accounts are presented on an income and expenditure basis, and the most common explanation is the effect of debtors and creditors in the council’s statement of balances. It should be possible to provide the auditor with details of the year-end debtors and creditors showing how the net difference between them is equal to the difference between Boxes 7 and 8.
- 2.25 As councils have no legal powers to hold revenue reserves other than those for reasonable working capital needs or for specifically earmarked purposes, whenever a council’s year-end general reserve is significantly higher than the annual precept, an explanation should be provided to the auditor.
- 2.26 Earmarked reserves, which are set aside for specific purposes and for savings for future projects, should be realistic and approved by the council. However, the amount of general reserve should annually be risk assessed and approved by the council.

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- 2.27 From the figures provided in the accounting statements, the external auditor is able to carry out an analytical review in order to improve knowledge about the council, gain some assurance about consistency and so to plan the audit work accordingly.

Bank reconciliation in support of the annual return

- 2.28 **The submission of the annual return must also be accompanied by a copy of the council's year-end bank reconciliation.** The bank reconciliation, which should cover all bank accounts held by the local council, is a key tool for management's assurance that the council's finances are being properly managed by those responsible. The lack of such a basic internal control would indicate an unacceptable control weakness and lead to additional audit work and cost which could otherwise be avoided. Further information about bank reconciliations is provided in Part 3.

Some notes about investments

- 2.29 It is rare for a local council to hold its reserves other than in the form of easily accessible bank deposit or other short-term savings accounts. These short-term investments are often used to maximise income from cash balances during the financial year.
- 2.30 Occasionally, circumstances require councils to consider making other types of investments, for example when saving for a future capital project or while deciding how to apply the proceeds of an asset sale or a donation.
- 2.31 Long-term investments in assets whose capital values may fluctuate carry considerable risks and require active management. Investment management is a specialist area. Prudent councils will always seek independent professional assistance when developing their investment strategy and before making decisions around this kind of expenditure. Such a strategy will consider whether it is appropriate to retain long term investments, and how to comply with the Secretary of State's investment guidance for local government bodies⁸ and relevant legislation⁹.
- 2.32 In deciding whether it is appropriate to make long term investments, the council should first develop an investment strategy. **If total investments are to exceed £500,000 the council must have a written Annual Investment Strategy.** The strategy will set out management arrangements for the investments held and procedures for determining the maximum periods for which funds may prudently be committed. It should ensure and demonstrate that the council has properly assessed the risk of committing funds to longer term investments and properly planned to comply with legislative requirements.

⁸ See Appendix 8: DCLG Guidance on Local authority Investments effective 1 April 2010

⁹ In particular, Local Government Act 2003 s 16 and Regulation 25 of the Capital Finance Regulations 2003 as amended

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- 2.33 For annual accounting purposes, all investments by local councils, other than in interest bearing savings accounts, should be identified as long-term investments and recorded as expenditure. Any investment with a maturity longer than 12 months is by definition a long-term investment and thus capital expenditure. When forward planning, councils should have regard to the fact that, in general, the acquisition of long-term investment assets reduces available balances and reserves.
- 2.34 The total proceeds of disposal of an investment should always be recorded as income in the financial year of the disposal. **Where the proceeds of disposal of investments or other assets purchased as capital expenditure exceed £10,000 and are capital receipts, councils must have regard to and apply the statutory restrictions placed on such receipts.**
- 2.35 A council may also, on occasion, decide to support its work by making a loan to a local body. This type of investment also creates a long-term asset for accounting purposes. However, such expenditure made by a parish council or charter trustee is not treated as capital expenditure.
- 2.36 When a council receives shares following a de-mutualisation of a Building Society or similar institution this also creates a long-term asset.
- 2.37 Part 3 below (paragraphs 3.47 to 3.54) provides more detailed guidance on how councils account for and report investments in the annual return.

The annual governance statement (Section 2 of the annual return)

- 2.38 Those who are responsible for the conduct of public business and for spending public money are accountable for ensuring both that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically efficiently and effectively.
- 2.39 In discharging this accountability, public bodies and their management (both members and officers) are responsible for putting in place proper arrangements for the governance of their affairs and the stewardship of the resources at their disposal.
- 2.40 Councils are expected to make a number of representations and assertions in statements of assurance which, together, comprise the annual governance statement covering internal control and accountability at the council. **The annual governance statement, together with the accounting statements, must be approved at a full council meeting.**
- 2.41 The statements of assurance are explained in the following paragraphs. Each statement is quoted in italics before a brief explanatory note. There is an additional representation required in cases where the council is the sole managing trustee of charitable assets or funds.

1. 'We approved the accounting statements prepared in accordance with the requirements of the Accounts and Audit Regulations and proper practices.'

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- 2.42 This first statement covers the accounts of the local council. Through the act of formally approving the accounts, the council asserts that it has prepared those accounts in the way prescribed by law and in accordance with proper practices.
- 2. 'We maintained an adequate system of internal control, including measures designed to prevent and detect fraud and corruption and reviewed its effectiveness.'*
- 2.43 This second statement covers the council's responsibility to ensure that its affairs are managed in accordance with proper standards of financial conduct and arrangements exist to prevent and detect fraud and corruption. The council also asserts that it has tested those arrangements at least once in the year to make sure they are working in an adequate and effective way.
- 2.44 A more detailed discussion about internal controls can be found in the section on risk management which starts at paragraph 2.99.
- 3. 'We took all reasonable steps to assure ourselves that there are no matters of actual or potential non-compliance with laws, regulations and proper practices that could have a significant financial effect on the ability of the council to conduct its business or on its finances.'*
- 4. 'We provided proper opportunity during the year for the exercise of electors' rights in accordance with the requirements of the Accounts and Audit Regulations.'*
- 2.45 The third and fourth statements cover the local council's responsibility to act within the law and to put in place proper arrangements to ensure that its financial affairs are conducted in accordance with the law and relevant regulations, including providing the opportunity for electors to exercise their rights to inspect in detail the council's financial records and ask questions of the auditor.
- 2.46 The third statement confirms that the council has actively made sure that it has only done things that it has the legal power to do, and, at the fourth statement, confirms that it has, during the year, allowed all persons who may be interested in doing so, the opportunity to exercise their statutory rights in relation to the council's accounts. A positive response confirms that the council has complied with the proper practices governing the way in which it carries out its business.
- 5. 'We carried out an assessment of the risks facing the council and took appropriate steps to manage those risks, including the introduction of internal controls and/or external insurance cover where required.'*
- 6. 'We maintained throughout the year an adequate and effective system of internal audit of the council's accounting records and control systems.'*
- 7. 'We took appropriate action on all matters raised in reports from internal and external audit.'*
- 2.47 The fifth, sixth and seventh representations cover a local council's responsibility to develop, implement and regularly monitor the effectiveness of systems of internal control covering:

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- the overall control environment, including internal audit;
- the identification, evaluation and management of operational and financial risks;
- budgetary control and monitoring arrangements; and
- the documentation and application of control procedures.

8. *'We considered whether any litigation, liabilities or commitments, events or transactions, occurring either during or after the year-end, have a financial impact on the council and where appropriate have included them in the accounting statements.'*

2.48 The eighth statement covers the local council's responsibility to conduct its financial affairs and to put in place proper arrangements to ensure that its financial standing is soundly based.

2.49 This statement provides assurance that the council has considered and disclosed in the annual return all matters relevant to its business, including any relevant events which have taken place in the period between the end of the financial year being reported and the date of the annual return, which could have an impact on its ability to continue its work.

9. *'Trust Funds (including charitable) - in our capacity as the sole managing trustee we discharged our responsibility in relation to the accountability for the fund(s)/assets, including financial reporting and, if required, independent examination or audit.'*

2.50 This representation is only used by councils that act as sole managing trustee of trusts that have already answered 'Yes' to the disclosure note in section 1 of the annual return; otherwise it should be answered as 'N/A'. The assertion confirms that the council acting as sole managing trustee has:

- complied with the requirements on trustees of the Charities Acts;
- arranged for an audit or independent examination of the trust's accounts (as required);
- completed all appropriate returns to the Charity Commission.

The external auditor's certificate and opinion (Section 3 of the annual return)

2.51 The issue of a certificate of completion by the external auditor effectively concludes and 'closes' the audit process for any given year. The external audit is 'opened' by the auditor appointing a date for the exercise of rights of electors.

2.52 The auditor's formal report recognises the relative statutory responsibilities of the council and its auditors and spells these out clearly in the annual return for all readers. It is important that members and external auditors alike recognise these different responsibilities and manage their affairs accordingly. Because of the different roles involved and the need to demonstrate independence, it is not possible, for example, for the external auditor to prepare the annual return for the council and then give his/her

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opinion on it. A more detailed presentation about the relative responsibilities of auditors and audited bodies may be viewed at Appendix 2.

- 2.53 The auditor's report contains an opinion on the accounts. This will state the basis on which the opinion is reached and note any exceptions to the opinion. The opinion in the auditor's report within the annual return represents a limited level of assurance which is appropriate to the circumstances of local councils operating at or below the £6.500,000 threshold. When councils maintain sound internal controls and other governance arrangements, the amount of work required from external audit can be correspondingly reduced to a proportionate level.
- 2.54 While in most cases the external auditor will not need to qualify his or her opinion in any way, this situation may arise. If the auditor has not been presented with the assurances required in relation to the accounts or the annual governance statement, or the information presented, the auditor cannot give an unqualified opinion, and then the auditor will report this as an exception to the opinion within the audit report. The annual governance statement item 7 should include consideration of actions taken by the council in response to any audit opinion qualifications or other matters raised in previous years, as well as to reports from internal audit.
- 2.55 If the auditor modifies the opinion in any way this represents a qualification of the accounts. Auditors may, however, wish to draw the council's attention to matters without qualifying the opinion. Such events are recorded in a separate section of the auditor's report, below the opinion, for information and action by the council.
- 2.56 **A local council, or in the case of a parish meeting, the chairman, is responsible for displaying a notice in a conspicuous place for a period of at least 14 days stating that the audit has been completed and that the accounts are available for inspection by local electors. The completed annual return bearing the external auditors certificate and signed opinion must either be published or be displayed alongside this notice.** The annual return is designed to make the display easy.
- 2.57 Where external audit reports that internal controls within a local council are inadequate, councils should take note of the increased risk of error, mistake and fraud. Local councils should consider responding to auditor reports urgently and in the context of their risk management arrangements (see below).

Internal audit's annual report (Section 4 of the annual return)

- 2.58 **Regulation 6 of the Accounts and Audit (England) Regulations 2011 imposes a duty on local councils to 'maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control'.** DCLG's Circular 03/2006¹⁰ explains where bodies can find relevant proper practices. In relation

¹⁰ See appendix 7

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to proper practices applying to their accounts, governance and internal control, local councils are directed to this Practitioners' Guide.

- 2.59** Internal audit is a key component of the system of internal control. The purpose of internal audit is to review and report to the council whether its systems of financial and other internal controls over its activities and operating procedures are effective. **The internal audit function must be sufficiently independent from the management of financial controls and procedures of the council which are the subject of review. The person or persons carrying out internal audit must be competent to carry out the role in a way that meets the business needs of the council.**
- 2.60 Internal audit is an on-going function reporting to the council at least once a year. It is, however, a function that should not only be carried out once each financial year; nor should it be carried out only at the completion of each financial year-end. It is good practice for internal audit to be undertaken regularly throughout the financial year to test the continuing existence and adequacy of internal controls.
- 2.61 It would be incorrect to view internal audit as the detailed inspection of all records and transactions of a council in order to detect error or fraud. Internal audit is the periodic independent review of a council's internal controls resulting in an assurance report to members designed to improve effectiveness and efficiency of the activities and operating procedures under the council's control. Managing the council's internal controls should be a day-to-day function of the council's staff and management, and not left for internal audit.
- 2.62 Having established what internal audit is and what its relationship with the council should be, it is important for councils to consider whether internal audit is proportionate to the needs, the size and the circumstances of the council.
- 2.63 Each council should set out its control objectives, usually in the form of standing orders and financial regulations. The smaller the council, the less onerous these need to be. Similarly, the scope of internal audit at smaller councils will be correspondingly less than at larger ones. The more complex the council is or becomes, in terms of its organisation and range of services, number of employees, etc. the wider ranging the scope of internal audit may be.
- 2.64 It is a matter for the council to determine the necessary scope and extent of its internal audit. **When securing an internal audit service, the council must make sure that it is fit for the purpose for which it is required at that particular council.** There is considerable practical experience among local councils in securing internal audit services which is summarised in the following paragraphs. More up to date information about locally available sources of internal audit can be obtained by contacting the secretaries of either NALC county associations or SLCC branches in your area.
- 2.65 Local councils secure internal audit in various ways and a range of options is given below (see box). It is always a matter for each local council to determine how best to meet the legal requirement for internal audit having regard to its business needs and circumstances.

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Local councils secure an internal audit in various ways including:

- appointing a local individual or a member of a panel of individuals administered by a NALC County Association or SLCC Branch. An individual will need to demonstrate adequate independence and competence to meet the needs of the local council;
- employing a competent internal auditor with sufficient organisational independence and status to undertake the role;
- purchasing an internal audit service from the principal authority where it is usual for a small team of employees to be established as internal audit; and
- purchasing an internal audit service from a local firm or specialist internal audit practice. The firm needs to have an understanding of the local government legal framework and a number of professional firms offer a service to public bodies, authorities and commercial companies. For the largest of local councils a specialist contractor appointment may be appropriate.

For examples of how local councils have secured internal audit see paragraph 2.71

- 2.66 Local councils should take into account their size and complexity when determining the way in which they will ensure that adequate internal audit arrangements are in place to meet legal requirements. **There are two key principles, which all local councils must follow in setting up their internal audit function, regardless of how procured: independence and competence.**
- 2.67 Independence means that whoever carries out the internal audit role does not have any involvement in the financial decision making, management or control of the council, or with the council's financial controls and procedures. It follows, for example, that the circumstances in which a councillor can demonstrate that they are sufficiently independent of the financial decision making and procedures of the council are difficult to envisage. Such a member would need to exclude themselves entirely from key financial decisions by the council in order to maintain their independence.
- 2.68 Similarly, it would not be appropriate for any individual or firm appointed by the council to assist with the council's accounting records, preparation of financial statements or the annual return, to be also appointed as internal audit. Particular care should be taken to avoid conflicts of interest in cases where an external provider of accounting software or services to the council, also offers internal audit services through an associate company, firm or individual.
- 2.69 **Those charged with carrying out internal audit must not be asked to provide or to offer consultancy or advice on the council's financial decisions, controls or processes.** For them to do so would prejudice their ability to give an objective and independent view on whether these meet the needs of the council.

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2.70 There is no requirement for a person providing the internal audit role to be professionally qualified, but essential competencies to be sought from any internal audit service include:

- understanding basic bookkeeping and accounting processes;
- understanding the role of internal audit in reviewing systems rather than undertaking detailed checks that are more appropriately the responsibility of management;
- awareness of relevant risk management issues; and
- understanding accounting requirements within the legal framework and powers of local councils.

2.71 There are a number of practical examples of how local councils have sourced their internal audit service which are shown in the box below.

A number of innovative and creative solutions have been developed by NALC county associations, SLCC branches and by local councils themselves for sourcing internal auditors at reasonable cost:

- local panels of members who are no longer able to carry out the internal audit function at their individual councils*;
- local panels of officers (usually clerks) providing internal audit services to each other and sometimes wider afield*;
- local residents who are retired accountants;
- local residents who are former members or clerks of the local council;
- local bank managers (some high street banks have community development policies which encourage their officers to take part in community activities – they are not allowed to charge);
- local business owners and managers – a number of larger corporations have policies similar to the banks with regard to community action;
- independent examiners for local charities;
- specialist internal audit service providers operating on a fixed fee or on an hourly rate;
- consortia organised by the NALC county association or SLCC branch (or sometimes in partnership) providing affordable internal audit services; and
- individuals identified by NALC or SLCC acting under their quality controls to provide internal audit services to local councils.

Additionally a number of local council tax authorities provide training and support for potential internal auditors for local councils.

*Subject to the guidance that one to one reciprocal arrangements between councils are insufficiently independent to satisfy this requirement.

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- 2.72 The duties of internal audit relate to reporting on the adequacy and effectiveness of a council's system of internal control. Internal audit's annual public report is made by completing section 4 of the annual return. Internal audit may also report in greater detail to the council as required.
- 2.73 The work of internal audit should be subject to an engagement letter on first appointment by the council, setting out the terms of the appointment. Engagement terms may include:
- roles and responsibilities;
 - audit planning;
 - reporting requirements;
 - assurances around independence and competence;
 - access to information, members and officers;
 - period of engagement;
 - remuneration; and
 - any other matters required for the management of the engagement by the council.
- 2.74 Councils and internal audit may also find helpful the following more detailed guidance on how internal audit is carried out.

	Subject	Guidance
1	Proper book-keeping	The basic record of receipts and payments is always the starting point of an accounting system; the majority of internal controls will work back to that original record. It is essential that the system requires that the basic cash book is kept up to date and balances are regularly verified against a bank statement or the actual cash in the petty cash tin. This record will also agree with the supporting vouchers, invoices or receipts. Even though the arithmetic may be automatic on a computer based system it is necessary to check that the additions and balancing are correct. The level of checking will depend on who does what and with what frequency. Where there is a computer based system, the reliability of information reported by the system depends on the quality and accuracy of data input, and how it is then processed, and so tests of the integrity of data input and processing should be considered. A councillor or member of staff may do the checking or verification; internal audit will test that the checking verification within the system has been undertaken.

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	Subject	Guidance
2	Financial Regulations Standing Orders Payment Controls	The first step in establishing a financial system is to identify the general rules applicable at council or committee meetings and in carrying out the council's business. The Standing Orders, Financial Regulations and other internal instructions do this. Model versions of Standing Orders and Financial Regulations are available from NALC and SLCC. Internal audit should have a copy of the current Standing Orders, Financial Regulations and any internal instructions. Internal audit's report to the council will include any recommendations for improvement in these documents arising as a result of their work during the year. The level of checking will depend on the content of the Standing Orders and Financial Regulations. The amount of work may well vary, and more extensive testing of compliance may be needed from time to time, but as a minimum, having established whether the council has within the year reviewed its Standing Orders and Financial Regulations for continued relevance, internal audit will test. In purchase order procedures: • that the correct number of estimates, quotes or full tenders depending on estimated value of contract have been obtained (Standing Orders will state the value at which tenders are required; Financial Regulations or Standing Orders will show the value where estimates or quotes only are required); • that proper purchase authority by council, a committee or officers (under clear delegated powers) is in place; and • that a proper legal power has been identified for the expenditure. In purchase payments: • that the supporting paperwork confirms that there is a fully approved invoice and authorisation for payment; and • that VAT is identified appropriately for reclaim. In most councils these checks can be limited to a sample of transactions selected at random, plus those which are large or unusual, such as each payment for a value in excess of £1,000, or some other figure appropriate to the level of activity of the council. The aim is for internal audit to check that the systems put in place by management are working and are appropriate. Standing Orders and Financial Regulations may well repeat the

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	Subject	Guidance
		statutory requirement to maintain 'a separate account' of expenditure and income under Local Government Act 1972 section 137 and Local Government Act 1986 section 5. Internal audit should check annually that such an analysis is kept and that the cash limit in section 137 is not exceeded. Internal audit may scrutinise the resulting list of expenditure and should consider whether the power is being properly used but would not check through for the correct analysis of every item. Internal audit should also check that payments of interest and principal in respect of loans (and investments if any are held) are in accordance with an agreed schedule.
3	Risk management	The greatest risk facing a local authority is not being able to deliver the activity or services expected of the council. The council is likely to be managing many of those risks when it reviews its insurance and its systems. The minutes are an essential record of such reviews. Budget setting and insurance review are annual activities; the review of systems may be less frequent. It is suggested that systems should be reviewed in some detail, unless triggered by external or internal audit reports, or change in risk, at least every four years or on the change of Clerk/RFO. This might be more appropriate for larger councils on a cyclical basis. Minutes should be checked by internal audit for any suggestion of unusual activity and evidence that risks are being identified and managed. More guidance regarding risk management can be found in this section, at paragraph 2.99 onwards.
4	Budgetary controls	Internal audit will not check the budget but will verify that a budget has been properly prepared by the council and adopted in setting the precept. The regular reporting of expenditure, and variances from budget, is an important part of the proper control of public money. Internal audit will expect to see the regular reports to council and the variance analysis. That variance analysis and the decisions of council or committee taken as a result may suggest areas for additional analysis by internal audit. Part of budgetary control is to ensure adequate but not excessive reserves or balances. Progress against budgets should be regularly monitored. It is particularly helpful when determining the likely precept that will be required for the following year. Internal audit will be keen to establish that this has taken place. More guidance on the budgetary process can be found in Part 3, at paragraph 3.29 onwards.

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	Subject	Guidance
5	Income controls	Internal audit will look for evidence that the precept and grant income is properly and promptly received. In value this is usually the largest item of income. Internal audit is more likely to focus on other income particularly where it is unusual or cash-based. Cash income brings higher risks, in turn requiring greater control by ticket issues, receipt issues, segregation of duties of the cashier and the invoice-raising clerk. The need for greater control implies a need for internal audit to verify the operation of all checks and balances. If the council has let property or holds investments, then the council should have established a system to ensure regular income collection; a diary of expected dates of income etc. Internal audit will look for evidence of such activity and any necessary progress or invoice chasing. If the income is from quoted investments there is a clear risk to be addressed in terms of identifying the investment policy to be followed, controls over who can initiate a change of investment and an awareness of the investment risks being accepted.
6	Petty cash procedure	Internal audit will be looking to see that there is an established system in place rather than ad hoc reimbursement. If the clerk is reimbursed for all small cost expenses or there is a separate cash float, a regular payment must be made to keep up to date. Internal audit would be looking to see that reimbursement is regular and evidence that on occasions an independent person has physically counted the cash balance and checked to be in agreement with the up-to-date record. The council should have a system for the regular approval of petty cash expenditure.

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	Subject	Guidance
7	Payroll controls	Internal audit will be seeking reassurance that the system is delivering the correct payments for wages and salaries and that PAYE/NIC is correctly deducted from the gross pay and paid to HM Revenue and Customs. Historically, one of the greatest areas of risk for local councils has been the improper payment of wages and salaries, together with the lack of proper deduction of income tax and national insurance contributions. There are some simple tests to establish whether a person is employed by a local authority or can be regarded as a contractor. The clerk is always regarded as an employee – as an ‘office holder’. As an employer, the council must operate PAYE/NIC. If correct deduction for tax or national insurance is not made by the employer, HM Revenue and Customs has the right to seek the lost tax and contributions from the employer as if the payments made were after deduction of the appropriate amounts (i.e. the amount sought is ‘grossed up’). There may also be a liability for interest and penalties that can increase the sum significantly. The clerk, even at the smallest of councils, will need to be able to produce evidence that the correct tax treatment of salary has been arranged with HM Revenue and Customs. HM Revenue and Customs often seek to avoid setting up a PAYE scheme for a single employee whenever possible, so will seek to ‘code out’ any parish council salary through other income, pension scheme or by direct assessment. The council should have an up to date letter from HM Revenue and Customs (addressed to the Council) confirming that arrangements to their satisfaction have been made for the particular employee. Internal audit may verify that evidence each year as part of the annual statement forming part of the annual return. Changes to contracts of employment (whether annual salary change, or other) require formal agreement by the council as well as being evidenced by a written statement to the employee. The council should record evidence of approved changes in employment contracts in employee records. Internal audit should check that this evidence is in place and agree sums paid to those sums shown as payable. The purpose of specifically investigating the PAYE/NIC system recognises the risks inherent in these items, either through fraud or error, and the risk of significant management time and penalties in making corrections if errors arise.

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	Subject	Guidance
8	Asset control	The Council is required to maintain an asset and investment register. In the smallest councils, this may only be a note produced for members and local electors. Internal audit will be interested in seeing that there is evidence that the continuing existence of owned and managed assets is checked on a regular basis. In a larger council the register may be hand written, typed or computer produced; the essence is the same in that the system should be verified on a regular basis. This verification should include confirmation that insurance cover is adequate and sufficient. If investments are held, the asset register will be a more active record; it should include details of cost, values, and expected income that can be checked against the actual income. Dates and references to minutes of the members' review of the investments against the investment policy might also be included. The Council will have regard to the advice from the Secretary of State published on 12 March 2004 (see Appendix 8). This guidance will be particularly important when considering de-mutualisation or privatisation shareholdings which have no identifiable cost and may have a volatile value.
9	Bank reconciliation	In most councils, the bulk of the financial records will be concerned with a current account and a form of deposit account at a bank or building society. A regular feature of the financial system will be the reconciliation of the balances shown on the statements with those calculated in the council's financial records. It is strongly recommended that on receipt of a bank statement, there should be a reconciliation of the appropriate cash book record. Internal audit will wish to see that this has been done, but should not undertake the reconciliation unless it requires re-performance. It may be appropriate for the year end balances and the reconciliation to be checked in detail. The basic cash book record must not be written up from the bank statements. That approach does not provide any form of control. The cash book record is written up from the council's records: cheque counterfoils and the paying-in books, together with the known direct payments and credits. It is the cash book record that is checked regularly against the bank statements to provide control.

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	Subject	Guidance
		The bank reconciliation should include a note of the historic cost of current investments held by the council, if any, so that this can also be monitored to ensure that these funds are performing in the way planned by the council and also so that the council can have, each time this is reviewed, as complete a picture as possible of its liquidity and available funds. As part of internal control, a member may be appointed to review the bank reconciliation in detail and to evidence that review by signing the reconciliation form and the bank statements.
10	Year-end procedures	It is the duty of the council and the RFO to produce the year-end accounting statements. Internal audit will be looking to see that the appropriate accounting basis is used, that the figures can be followed through on working papers and adjustments, transfers, contra entries etc. are fully explained and justified. Internal audit would not be expected to check all figures but will probably verify a small sample and the totals. Councils accounting on an Income and Expenditure basis will have a system in place for identifying outstanding amounts (receivable and payable) and then for deciding on their materiality for inclusion in the accounting statements. Internal audit will scrutinise the lists of creditors and other balances to ensure that the system is working adequately and that the RFO has correctly identified transactions in the one year that may in whole or part relate to another.

- 2.75 It is not possible to draw up a standard internal audit programme for local councils, in view of the need for each programme to address the particular needs of each council. It is also important for councils to recognise that internal audit's function is to test and report to them on whether the council's system of financial control put in place by management is adequate and working satisfactorily. It is not for the external auditor, nor is it a matter for internal audit, to actively seek evidence of fraud, corruption, error or mistake. Internal audit's role is to assist the council in fulfilling its responsibility to have and maintain proper internal control arrangements and those for the prevention and detection of fraud, error or mistakes.
- 2.76 Internal audit reports to the council and its work is, to a certain extent, capable of constraint and direction by the council. The external auditor reports to the council but seeks direction from guidance issued by the Audit Commission and from the legislation under which they are appointed.

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- 2.77 It is proper for internal audit to carry out other tests on the systems of the council. Such tests may be suggested by the external auditor or by the council's own risk management process.
- 2.78 A possible approach to testing by internal audit is contained in Appendix 9 to this guidance. This is not a checklist requiring completion, but a suggested method of approach.
- 2.79 **All internal audit work must be reported to the council.** Any report by internal audit is addressed to the council, may recommend actions to be taken by the council, and should be treated as a document open to view by local taxpayers.
- 2.80 Good internal audit reporting includes:
- Description and scoping of the risk areas covered;
 - prioritisation of any recommendations;
 - a conclusion about the overall adequacy and effectiveness of the council's internal control arrangements; and
 - management's draft response including a recommended action plan identifying individual responsibilities and timing.

The review of the system of internal audit

What does the law say you have to do?

- 2.81 The regulations require larger authorities to carry out a review of the effectiveness of their system of internal audit at least once a year. This is not a requirement for local councils but it remains good practice and local councils should carry out a review periodically. It is recommended that reviews be carried out no longer than three years apart and also in the year of any change of internal auditor.
- 2.82 Local councils completing assertions 2, 6 and 7 in the annual governance statement in the annual return should consider the outcomes of any review of internal audit.
- 2.83 Any review should balance the council's internal audit needs and usage. It should be designed to provide sufficient assurance for the council that standards are being met and that the work of internal audit is effective. Councils judge the extent and scope of the review by reference to their own individual circumstances.

So what needs to be reviewed?

- 2.84 The review should be designed to assure the council that it has maintained 'in accordance with proper practices an adequate and effective system of internal audit of its accounting records and system of internal control'.
- 2.85 Local councils source their internal audit in a number of ways (which are described elsewhere in this guide). The starting point for a review should be an assessment

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against the internal audit standards set out in paragraphs 2.58 to 2.80. This should include, as a minimum, making an assessment of each of the following:

- The scope of internal audit
- Independence
- Competence
- Relationships
- Audit planning and reporting

Who should carry out the review?

- 2.86 A key point to note is that any review should be undertaken by the council. This is not a review that can be carried out by the external auditor or as part of the annual audit. Nor is it something that can be delegated to the clerk or RFO, and certainly not to internal audit.
- 2.87 Although the internal audit provider cannot be allowed to influence the direction or extent of the review, it is good practice to seek their input into the process.
- 2.88 There are no hard and fast rules about who actually performs the review or how it is carried out, but councils may wish to set up a small working party for this purpose or ask an appropriate committee. Regardless of how the review is carried out, the results should always be reported to and considered by a full meeting of the council.
- 2.89 There is no single approach to review of internal audit that will suit all local councils. Much will depend upon the size of the council and arrangements it already has in place for conducting the wider review of its system of internal control, and risk management generally.

What should the review cover?

- 2.90 Areas for review should be based around the components of internal audit which are identified in paragraph 2.85. These will include, principally, a consideration of the extent to which internal audit adds value and how well it is helping the delivery of the council's objectives.
- 2.91 The effectiveness of internal audit should not be judged solely by the extent of compliance with expected standards. The review is primarily about effectiveness, not process. In essence, the focus of this review should be on the quality of delivery of the internal audit service i.e. reliable assurance about the council's internal controls and its management of risk.
- 2.92 A checklist to assist councils in carrying out the two principal aspects of the review of internal audit - compliance with standards and overall effectiveness - is provided below.

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What evidence can be used?

2.93 Wherever possible, evidence to support the review should be gathered throughout the year. There are many possible sources of evidence and some examples are set out below:

- Previous year's review and action plan.
- Annual report by internal audit.
- Periodic reports from internal audit, if any, which could include one or more of the following.
 - An internal audit plan.
 - Cyclical internal audit monitoring reports.
 - The results of any investigations.
 - Review of performance indicators, if used.
- Any reports by the external auditor covering internal audit work or on key financial systems.
- Results of any other external reviews of internal controls or aspects of them.

What is the outcome of the review?

2.94 If the review identifies any areas for development or change in internal audit, an action plan should be produced for the council to manage the remedial process. The action plan should set out the areas of improvement required, any proposed remedial actions, the people responsible for delivering improvement, and the deadlines for completion of the actions.

What is the timescale?

- 2.95 Internal audit is a key component of a local council's internal controls. Local councils report each year on internal controls so it is recommended that internal audit reviews should be carried out at least once every three years.
- 2.96 At each change of internal audit, the council should also review the outgoing internal audit and set out its requirements for the incoming internal audit.
- 2.97 Monitoring of any action plans addressing weaknesses in internal audit should be continuous until the remedial actions are complete.

Is training available?

2.98 Those carrying out the review of internal audit will need to understand the purpose of the review, what it includes, and how to carry it out. Training on this may be delivered by NALC and SLCC or from the local district or unitary authority.

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Internal Audit Review Checklist - Part 1 - Meeting standards

Expected standard	Evidence of achievement	Yes or No	Areas for development
1. Scope of internal audit	Terms of reference for internal audit were (re)approved by full council on [date]. Internal audit work takes into account both the council's risk assessment and wider internal control arrangements. Internal audit work covers the council's anti-fraud and corruption arrangements.		
2. Independence	Internal audit has direct access to those charged with governance (see Financial Regulations). Reports are made in own name to management. Internal audit does not have any other role within the council/board.		
3. Competence	There is no evidence of a failure to carry out internal audit work ethically, with integrity and objectivity.		
4. Relationships	All responsible officers (Clerk and RFO) are consulted on the internal audit plan. (Evidence is on audit files). Respective responsibilities for officers and internal audit are defined in relation to internal control, risk management and fraud and corruption matters (job descriptions and engagement letter). The responsibilities of council members are understood; training of members is carried out as necessary. (See Member training plan).		
5. Audit Planning and Reporting	The annual internal audit plan properly takes account of all the risks facing the council and has been approved by the council [date]. Internal audit has reported in accordance with the plan on [date].		

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Internal Audit Review Checklist - Part 2 - Characteristics of Effectiveness

Characteristics of 'effectiveness'	Evidence of achievement	Yes or No	Areas for development
Internal audit work is planned	Planned internal audit work is based on risk assessment and designed to meet the council's needs.		
Understanding the whole organisation its needs and objectives	The annual audit plan demonstrates how audit work will provide assurance for the council's Annual Governance Statement.		
Be seen as a catalyst for change	Internal audit supports the council's work in delivering improved services to the community.		
Add value and assist the organisation in achieving its objectives	The council makes positive responses to internal audit's recommendations and follows up with action where this is called for.		
Be forward looking	In formulating the annual audit plan, national agenda changes are considered. Internal audit maintains awareness of new developments in the services, risk management and corporate governance.		

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Characteristics of 'effectiveness'	Evidence of achievement	Yes or No	Areas for development
Be challenging	Internal audit focuses on the risks facing the council. Internal audit encourages managers/members to develop their own responses to risks, rather than relying solely on audit recommendations.		
Ensure the right resources are available	Adequate resource is made available for internal audit to complete its work. Internal audit understands the council and the legal and corporate framework in which it operates.		

Risk management

- 2.99 In all types of undertaking, there is the potential for events and consequences that may either be opportunities for benefit or threats to success. Local councils are no different and risk management is central to their strategic management.
- 2.100 Risk management is the process whereby local councils methodically address the risks associated with what they do and the services which they provide. The focus of good risk management is to identify what can go wrong and take proportionate steps to avoid this or successfully manage the consequences.
- 2.101 Risk management is not just about financial management; it is about protecting the achievement of objectives set by the council to deliver high quality public services. The failure to manage risks effectively can be expensive in terms of litigation and reputation, the ability to achieve desired targets, and, eventually, on the local community's Council Tax bills.
- 2.102 The local council audit approach encourages local councils to address these issues by placing emphasis on the need to keep under review and, if need be, strengthen their own corporate governance arrangements, thereby improving their stewardship of public funds and providing positive and continuing assurance to taxpayers.
- 2.103 The importance of looking afresh at risk comes in the wake of a more demanding society, bold initiatives and more challenge when things go wrong. It also arises because of the significant changes taking place as a result of the Government's localism agenda.
- 2.104 The council generally and members individually are responsible for risk management because risks threaten the achievement of policy objectives. As a minimum, at least once each year members must:
- **take steps to identify and update their record of key risks facing the council;**
 - **evaluate the potential consequences to the council if an event identified as a risk takes place;**
 - **decide upon appropriate measures to avoid, reduce or control the risk or its consequences; and**
 - **record any conclusions or decisions reached.**
- 2.105 It is impossible, and potentially dangerous, to attempt to present a suggested list of the risks which local councils face, and this guidance does not attempt to do so. The range, nature, complexity and scale of the business of councils vary.

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- 2.106 Similarly, the priorities and service delivery objectives of one council will differ from those of others. For this reason each council should identify, for itself, the key risks to achieving successfully its priorities and service objectives.
- 2.107 Local councils may find it helpful to use, as a starting point, the examples of risk set out in the three tables at the end of this section of the guidance.
- 2.108 Support for councils wishing to improve their risk management arrangements, over and above that provided by this guidance, is available through training that may be requested from the technical support teams of both NALC and SLCC, or from other training providers. In identifying training needs, councils may wish to seek the professional input of their insurance provider and refer to various elements of the National Training Strategy.
- 2.109 One reason why risk identification can appear daunting is that, without doing anything else, it could lead to a long list of potential threats with no sense of their relative importance. For this reason the council should also evaluate the potential consequences of a risk occurring and consider how likely this is.
- 2.110 For example, a single large capital project will present a number of separate risks that will each require evidenced assessment and response to make the project manageable. The risk assessment in such a case may well lead to the very reasonable conclusion that the biggest risk is that the council does not possess the skills internally to successfully deliver the project and that outside assistance is required.
- 2.111 The consequences of an identified risk may include immediate financial loss. But even if the immediate impact is non-financial (such as an adverse impact on the council's reputation) this can have financial consequences in the longer term, for example, if this impedes the council's ability to bid for grant funds in the future.
- 2.112 The assessment of potential impact need not be any more complex than classifying each impact as high, medium or low. At the same time it is a good idea to assess how likely a risk is to occur and this too can be done using high, medium and low categories. These value and probability assessments enable the council to decide which risks it should pay most attention to when considering what measures to take to manage them.
- 2.113 After identifying and evaluating risks, councils should decide the appropriate measures to take in order to avoid, reduce or control the risks or their consequences. Examples of control measures relevant to some of the risk areas which councils are likely to face are given in the three tables at the end of this section of the guide.
- 2.114 The council's internal audit has a role in reviewing the effectiveness of control measures that the council decides to put in place. Examples of internal audit tests to confirm how effective are the measures and controls designed by the

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council in respect of identified risks are also set out in the three tables at the end of this section.

2.115 The tables are, for ease of reference, grouped into the three main types of decision that councils take in relation to managing risk, having considered the controls which they need to have in place. These are to:

- take out insurance (table 1);
- work with a third party to manage the risk (table 2); or
- self-manage the risk (table 3).

2.116 The tables are not intended to be exhaustive and they cover topics which are not relevant to all councils. They are intended to create a starting point for the development of a bespoke system of risk management for each local council.

Table 1 Areas where there may be scope to use insurance to help manage risk

Risk identification

Insurance cover for risk is the most common approach to certain types of inherent risks.

- ✓ The protection of physical assets owned by the council – buildings, furniture, equipment, etc. (loss or damage).
- ✓ The risk of damage to third party property or individuals as a consequence of the council providing services or amenities to the public (public liability).
- ✓ The risk of consequential loss of income or the need to provide essential services following critical damage, loss or non-performance by a third party (consequential loss).
- ✓ Loss of cash through theft or dishonesty (fidelity guarantee).
- ✓ Legal liability as a consequence of asset ownership (public liability).

Internal controls

A council's internal controls may include the following.

- ✓ An up to date register of assets and investments.
- ✓ Regular maintenance arrangements for physical assets.
- ✓ Annual review of risk and the adequacy of cover.
- ✓ Ensuring the robustness of insurance providers.

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Internal audit assurance

Internal audit testing may include the following.

- ✓ Review of internal controls in place and their documentation.
- ✓ Review of management arrangements regarding insurance cover.
- ✓ Testing of specific internal controls and reporting findings to management.

Table 2 Areas where there may be scope to work with others to help manage risk

Risk identification
The limited nature of internal resources in most local councils means that councils wishing to provide services often buy them in from specialist external bodies. ✓ Security for vulnerable buildings, amenities or equipment. ✓ Maintenance for vulnerable buildings, amenities or equipment. ✓ The provision of services being carried out under agency/partnership agreements with principal authorities. ✓ Banking arrangements, including borrowing or lending. ✓ Ad hoc provision of amenities/ facilities for events to local community groups. ✓ Markets management. ✓ Vehicle or equipment lease or hire. ✓ Trading units (leisure centres, playing fields, burial grounds, etc.). ✓ Professional services (planning, architects, accountancy, design, etc.).
Internal controls
A council's internal controls must/should include the following. ✓ Standing orders and financial regulations dealing with the award of contracts for services or the purchase of capital equipment. ✓ Regular reporting on performance by suppliers/providers/contractors. ✓ Annual review of contracts. ✓ Clear statements of management responsibility for each service. ✓ Regular scrutiny of performance against targets. ✓ Adoption of and adherence to codes of practice for procurement and investment. ✓ Arrangements to detect and deter fraud and/or corruption. ✓ Regular bank reconciliation, independently reviewed.

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Internal audit assurance

Internal audit testing may include the following.

- ✓ Review of internal controls in place and their documentation.
- ✓ Review of minutes to ensure legal powers are available, and the basis of the powers recorded and correctly applied.
- ✓ Review and testing of arrangements to prevent and detect fraud and corruption.
- ✓ Review of adequacy of insurance cover provided by suppliers.
- ✓ Testing of specific internal controls and reporting findings to management.

Table 3 **Areas where local councils may self-manage risk**

Risk identification
In the event that following risk assessment the council determines that the appropriate response to some identified risks is to manage them 'in-house', the council should review internal controls to check they are fit for this purpose.
Internal controls
A council's internal controls should include the following: ✓ Safe and efficient arrangements to safeguard public money (see Appendix 10) ✓ Regular scrutiny of financial records and proper arrangements for the approval of expenditure. ✓ Recording in the minutes the precise powers under which expenditure is being approved. ✓ Regular employer returns to HM Revenue and Customs; contracts of employment for all staff, annually reviewed by the Council, systems of updating records for any changes in relevant legislation. ✓ Regular returns of VAT; training the responsible officer in matters of VAT and other taxation issues as necessary. ✓ Regular budget monitoring statements. ✓ Developing systems of performance measurement. ✓ Procedures for dealing with and monitoring grants or loans made or received. ✓ Minutes properly numbered and paginated with a master copy kept in safekeeping. ✓ Documented procedures to deal with enquiries from the public. ✓ Documented procedures to deal with responses to consultation requests. ✓ Documented procedures for document receipt, circulation, response, handling and filing. ✓ Procedures in place for recording and monitoring Members' interests and Gifts and Hospitality received. ✓ Adoption of codes of conduct for members and employees.

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Internal audit assurance

Internal audit testing may include the following.

- ✓ Review of internal controls in place and their documentation.
- ✓ Review of minutes to ensure legal powers in place, recorded and correctly applied.
- ✓ Testing of income and expenditure from minutes to cashbook, from bank statements to cashbook, from minutes to statements etc. including petty cash transactions.
- ✓ Review and testing of arrangements to prevent and detect fraud and corruption.
- ✓ Testing of disclosures.
- ✓ Testing of specific internal controls and reporting findings to management.

Part 3 - Accounting guidance for small local councils

This part provides guidance on how local councils meet their statutory responsibilities most effectively, particularly in relation to the preparation of the annual accounting statements (section 1 of the annual return) It is structured as follows:

- Introduction
- Routine financial procedures
- Procedures for prompt and accurate recording of transactions and the prevention and detection of inaccuracies and fraud
- The budgeting process
- Some notes on Capital Budgeting
- The Cash Book
- Accounting for fixed assets
- Preparing the annual return
- Audit notices and the presentation of the annual return

Introduction

- 3.1 The Accounts and Audit Regulations provide a comprehensive framework for the accounts of a local council, taking the wider definition of what constitutes 'the accounts' as:
- the day-to-day records of financial activity that help with the management of the council's funds – the books of account; and
 - the summary of the council's financial activity that is prepared at the end of each year for reporting to the public – the accounting statements (section 1 of the annual return).
- 3.2 Manually kept books of account, or an effective computerised accounting system, should provide the basis for the accounting statements, in that the accounting statements are compiled from the information recorded in the books. But the books of account are important in themselves in the running of the council throughout the year. A good set of books will allow a council to appreciate at any time:

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- the amounts that it has spent in the year, the income it has received and its financial commitments;
- whether, in the light of this information, its spending plans for the rest of the year are still affordable;
- the assets that it owns (things that will be of economic benefit to the council in the future: for example buildings, vehicles, investments, cash) and the liabilities that it owes (for example, outstanding payments for goods and services, borrowings); and
- the extent to which its funds are secured from loss by internal checks and controls.

3.3 These objectives are sensible in themselves, but so as to ensure that all councils achieve a minimum standard of accounting, the Accounts and Audit Regulations specify what councils do to achieve them. **Local councils must ensure that:**

- **the body's accounting system and the form of their accounts and supporting accounting records are determined by the RFO;**
- **the RFO ensures that the accounting systems are observed and that the accounts and supporting records of the body are maintained in accordance with proper practices and kept up to date;**
- **accounting records are sufficient to show the body's transactions and to enable the RFO to ensure that the accounting statements complies with the Accounts and Audit Regulations;**
- **accounting records, in particular, contain:**
 - **entries, from day to day, of all sums of money received and expended by the body and the matters to which the income and expenditure or receipts and payments account relate;**
 - **a record of the assets and liabilities of the body; and**
 - **a record of income and expenditure by the body in relation to claims made by the body for contribution, any grant or subsidy from the Government; and**
- **the accounting control system includes:**
 - **measures to ensure that the financial transactions of the body are recorded as soon as reasonably practicable and as accurately as reasonably possible, measures to enable the prevention and detection of inaccuracies and fraud, and the ability to reconstitute any lost records;**
 - **identification of the duties of officers dealing with financial transactions and divisions of responsibilities of those officers in relation to significant transactions; and**
 - **procedures for uncollectible amounts, including bad debts, not to be written off except with the approval of members, or under delegated authority, the RFO, and for the approval to be shown in the accounting records.**

Routine financial procedures

- 3.4 This section of the guidance summarises the requirements of the Accounts and Audit Regulations, for the accounting framework to be maintained by local councils.
- 3.5 **All local councils, including parish meetings where there is no parish council, must under section 151 of the Local Government Act 1972 appoint an officer to be responsible for the financial administration of the council.** The clerk to the council is often also appointed as the RFO, but this is not automatically the case. The council should formally determine in whom the responsibility vests, recognising that there are particular risks that arise in the unusual circumstances where an elected member is appointed (unpaid) as the RFO. Decisions about appointing the RFO should always be the subject of a full risk assessment and consideration evidenced by a council minute. The proper segregation of duties means that the Chairman of the council or of the Finance Committee should never be appointed (even on a short-term basis) either as Clerk or as RFO.
- 3.6 The appointment of an RFO does not mean that members then have no responsibility for the financial health of the council. On the contrary, members continue to be accountable for ensuring that the council does not live beyond its means, but the RFO takes on the duty of designing and implementing the accounting arrangements that will assure members that finances are being properly managed.
- 3.7 The following table summarises the duties that are placed on the RFO and suggests the arrangements that might be put in place to ensure that these duties are met.

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Statutory duty	Possible arrangements
1 The RFO determines the body's accounting system and the form of its accounts and supporting accounting records.	• The council should make it a formal duty of the responsible officer to keep accounting systems under continual review to ensure their adequacy for the council's purposes. • The council should ensure that the RFO is competent to meet their responsibilities (either by requiring certain qualifications on appointment or by training) and providing sufficient resources for the running of the systems. • The accounting systems that are used will be particular to each individual council. The smallest may require nothing more than an account book and a file in which to store bills. Larger councils might need an integrated computer package, with facilities for payroll, debtors, creditors and VAT.
2 The RFO ensures that the accounting systems are observed and that the accounts and supporting records of the body are maintained in accordance with proper practices and kept up to date.	• Measures for ensuring accounting systems are observed include making available a written record of procedures, training staff to operate the systems properly and regular audits to confirm effective operation. • Certain procedures are designed to confirm that accounting systems have been observed, the most notable being the preparation of the bank reconciliation (see below). Good practice would be to report to each council meeting that the latest bank reconciliation has been prepared successfully. • The proper practices specified by the Accounts and Audit Regulations are represented by the contents of this guide. • The requirement to be up-to-date means that transactions should be entered in the records as soon as possible after they take place. Backlogs should not be allowed to develop, and, where other officers are responsible for spending money and collecting income, then procedures will need

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Statutory duty	Possible arrangements
	to be in place to inform the RFO of their dealings for entry in the accounts. Timeliness is made easier if the council has arrangements for the latest financial position to be reported at each council meeting.
3 The accounting records are sufficient to show the body's transactions and to enable the RFO to ensure that the accounting statements comply with the Accounts and Audit Regulations.	• The RFO must ensure that the accounting systems are sufficiently detailed to record each individual transaction that is entered into. For instance, where the council charges for village hall bookings, the books should record each individual booking rather than a total for the value of all bookings made in any week. • Accounting records will be sufficient to ensure that the accounting statements comply with the Accounts and Audit Regulations, if they allow the analysis of transactions in accordance with section 1 of the annual return.
4 The accounting records in particular contain: • entries from day to day of all sums of money received and expended by the body and the matters to which the income and expenditure or receipts and payments account relate; • a record of the assets and liabilities of the body; and • a record of income and expenditure of the body in relation to claims made by them for contribution, grant or subsidy from the	• Day-to-day records (see Example 1) • Assets and liabilities register (see Example 2) • Grants register (see Example 3) Note – Examples may be found at the end of Part 3.

Part 3 - Accounting guidance for local councils

Statutory duty	Possible arrangements
government.	
5 The accounting control systems include: • measures to ensure that the financial transactions of the body are recorded as soon as reasonably practicable and as accurately as reasonably possible, measures to enable the prevention and detection of inaccuracies and fraud, and the ability to reconstitute any lost records; • identification of the duties of officers dealing with financial transactions and divisions of responsibilities of those officers in relation to significant transactions; and • procedures for uncollectible amounts, including bad debts, not to be written off except with the approval of the RFO and for the approval to be shown in the accounting records.	• Document and adopt control systems to clarify everyone's duties and responsibilities and to encourage a culture that does not tolerate bending or breaking the rules. • Review systems at least annually or more frequently if required following any significant change of procedure or key personnel. • Add new systems if there is a business need to do so. • Report annually to the council prior to their completion of the annual return.

Procedures for prompt and accurate recording of transactions and the prevention and detection of inaccuracies and fraud

- 3.8 The guidance in the following paragraphs should be taken into consideration by councils when determining their procedures for prompt and accurate recording of transactions and the prevention and detection of inaccuracies and fraud.

Accounts for payment

- 3.9 **Section 135 of the Local Government Act 1972 requires councils to make Standing Orders that include provisions for securing competition and regulating the manner in which tenders are invited.** To comply with these requirements, councils should set within their Financial Regulations a limit for the purchase of goods and services above which three estimates or quotes should be invited from persons or firms competent to do the work. Standing Orders will state a higher value above which competitive tenders in sealed envelopes should be invited. It is the responsibility of councils to determine their own limits that are most appropriate to local circumstances.
- 3.10 As far as possible, a fully priced official order should be sent to suppliers in advance of delivery of goods. Official orders both commit a supplier to a price and help prevent unauthorised credit being granted in the council's name. On receipt of invoices, verification that the relevant goods or services have been received should be obtained and invoices checked to ensure that the arithmetic is correct, agreed discounts have been deducted and everything is acceptable regarding reclaiming the VAT. Practitioners should keep up to date with VAT Guidance issued by HM Revenue and Customs and, from time to time, by NALC and SLCC.
- 3.11 **Local councils must put in place safe and efficient arrangements to safeguard public money as set out in Appendix 10 to this guide.** The payments process should always be carried out in accordance with the council's own Financial Regulations within which the principles of safeguarding public money are embedded. Cheques should only be released once confirmation has been obtained that adequate funds are available. In any event, all payments made since the last meeting should be reported to the next council meeting. Members should never sign blank cheques, funds transfers or similar bank instructions which are presented unsupported by the appropriate documentation.
- 3.12 The council should develop control procedures for any payments by bank transfer, or other electronic means, taking into account the risks brought about by the ease and speed of these transactions and the difficulties faced in unravelling them should they go wrong. In developing adequate control procedures members should bear in mind legal requirements regarding official signatures.
- 3.13 If there is any doubt as to how much the council owes to one of its regular suppliers, the supplier should be asked to send a statement of the council's account. It would be appropriate to request statements as at 31 March each year to assist with the preparation of the annual return.

Receipts

- 3.14 Cash and cheques should be entered into the cash book on the date of receipt and banked promptly and intact (i.e. without any of the cash being kept back for spending). Practitioners should be aware that some receipts may require VAT to be accounted for and paid over by the council, particularly where sales of items are involved and certain thresholds have been reached. Once again, the RFO should be familiar and up to date with the rules governing such transactions. These are published by HM Revenue and Customs and accompanied by guidance for practitioners.
- 3.15 Where any person, such as a swimming pool manager or cemetery superintendent or any other employee or member carrying out the usual activities of the council, receives money on behalf of the council, their responsibility is to ensure that such funds are either banked or promptly deposited with the RFO.
- 3.16 Anyone handling cash on behalf of the council should be properly trained in the procedures that they are to operate. They should be provided with the appropriate duplicate receipting and recording documents. With such an arrangement, the responsible person in receipt of the money would need to maintain a record showing, in strict date order, the money and cheques received and bankings or deposits made. This collection and deposit record needs to be examined from time to time to ensure that bankings are made regularly and that the cumulative totals match to the cash book and banks' statements.

Cash balances

- 3.17 **Where a council builds up balances these must be safeguarded by investing in an appropriate account. Investing balances by local councils must be done prudently and in accordance with the requirements of the Local Government Act 2003 and Guidance issued by the Secretary of State (see Appendix 8).**
- 3.18 Before finalising and adopting procedures and internal control systems involving cash, the RFO should always check the requirements of insurers under Fidelity Guarantee insurance cover arrangements, which may well specify the amount, location and minimum security arrangements required regarding the handling of cash or bank balances.
- 3.19 The number of petty cash floats should be kept to a minimum and should not be used when an official order is more appropriate. The floats should be adequate in size to meet small items of expenditure and should not require reimbursement more frequently than once a month – this will require careful setting of float levels.
- 3.20 Adequate records of the receipts and payments should be maintained for each float and regular reconciliation performed, usually with such regularity that successful reconciliation can be reported at each council meeting.

Debts due to the council

- 3.21 Effective debt collection is an essential part of proper financial management. Local councils should ensure that invoices raised are paid promptly or that appropriate recovery action has been taken. Additionally, irrecoverable debts should be written off, after full consideration of the possibilities for and the likely costs of pursuing the debt.
- 3.22 Debt monitoring arrangements should be in place covering all activities of the council which involve receiving payment. For example, if the council rents out a number of allotments, a separate record may be appropriate for that purpose. The record would need to include details of the person who owes the debt, the amount, any arrears brought forward at the start of the accounting period, amounts due in the year, amounts paid in the year, any debts written off, and a note of the current state of any recovery action taken.
- 3.23 At the end of each year, the record will need to be reconciled to ensure that the figure for arrears brought forward plus new amounts due, less new receipts and write-offs, balances to the total arrears that need to be carried forward into the next year's accounts.

Payroll

- 3.24 **The remuneration payable to all employees must be approved in advance by the council.** Local councils should have regard to the guidance on employment matters issued jointly by the NALC and SLCC. Local councils with any employees are, by definition, employers and are required to apply Pay as You Earn (PAYE). PAYE taxes and National Insurance contributions (NIC) should be calculated and recorded for every employee. Deductions should be paid to the Collector of Taxes on or before the date prescribed. In addition the general requirements of the Employment Acts apply but are not within the scope of this guidance.
- 3.25 **HMRC issued guidance in March 2011 setting out the correct Income Tax and NIC treatment of parish clerks. This guidance confirms that a parish clerk is an office holder and that all office holders are subject to PAYE. This means that parish clerks:**
- **can never be considered as self-employed for tax or NIC purposes;**
 - **cannot be paid 'gross'; and**
 - **fall to be taxed under PAYE.**
- 3.26 In many local councils, the clerk will also be appointed as the RFO. HMRC guidance confirms that where the RFO is a separate appointment, the RFO is also an office holder and is subject to the same Tax and NIC rules as the clerk.
- 3.27 Local councils should pay particular attention to situations where contractors are engaged to carry out the council's services. Councils should always be alert to the risk that occasions may arise when contractors cease to be self-employed and become employees for tax purposes.

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- 3.28 As part of risk management, written confirmation should always be sought from HMRC to ensure that payments for services provided by contractors are being correctly treated; otherwise councils may find themselves with unexpected and significant liabilities to pay income tax and employers National Insurance contributions. Care must be also taken when making any payments of expenses or allowances to non-employees, for example to the Chair or to other councillor members, which should also be considered as falling within the scope of PAYE.

Insurance

- 3.29 **All local council employers are required by law to take out employers' liability and decide the appropriate level of fidelity guarantee insurance.** All cover should be risk based and kept under constant review to make sure it adequately reflects changes in circumstances.
- 3.30 Adequate insurance against third party risks is vital especially if a local council owns property such as bus shelters, swimming pools and playground equipment. The council should review the range and value of insurance cover each year. At the expiry of each policy, consideration should be given to inviting competitive quotations for the new policy.

The budgeting process

- 3.31 The preparation of an annual budget is one of the key statutory tasks to be undertaken by a local council, irrespective of its size. The budget has three main purposes:
- it results in the council setting the precept for the year;
 - subject to the council's Financial Regulations, it gives the clerk and other officers overall authority to make spending commitments in accordance with the plans approved by members; and
 - it provides a basis for monitoring progress during the year by comparing actual spending against planned spending.
- 3.32 The importance of the budget should not be underestimated. It is essential that council members understand how it is put together and how it should be used in the running of the council. At its simplest the budget compares what a council would like to spend in the forthcoming year on local services with the amount of income it expects to generate, with the excess of planned spending over income being made up by the precept. But as the year progresses, things will not always go to plan and the prospect of a shortfall of available cash during a financial year can present a significant risk. Reviewing the budget against actual expenditure regularly gives members early warning about the likelihood of a shortfall (or surplus) and helps them to decide what responsive action to take.

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3.33 The following table sets out the process for preparing and making use of the annual budget.

Process	Good practice
1 Deciding the form of the budget	The first decision for the council is to determine the level of detail at which to prepare the budget. This involves scheduling out all the headings under which the council expects to make payments or is likely to receive cash (for example, clerk's remuneration, village hall booking fees). An estimate will then be prepared for each of these headings of the value of transactions that will take place in the next year.
2 Review the current year budget and spending	In making estimates, most councils will start by looking at current year figures, with three main purposes: • to identify activities that are being carried out this year that will also be carried out next year and need to be budgeted for again (for example payment of the clerk, running costs of the village hall); • to identify things that are happening in the current year that will not happen next year and do not need to be budgeted for again (for example a one-off grant to the local sporting association for renovating their premises, running costs of a sports centre that is to be closed); and • to identify items that are not in the current year budget, and need to be added for next year's budget (for example major drainage works in the cemetery, employment of a caretaker for the village hall). This is called 'incremental budgeting', as it builds on the decisions that the council has taken in the past. An alternative approach that councils sometimes take is to start with a clean piece of paper and build a fresh budget that is not constrained by what has happened in previous years. This is sometimes described as 'zero-based' budgeting.

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Process	Good practice
3 Determine the cost of spending plans	Having determined what the council wants to spend its money on, the next stage is to work out the costs of its plans. For existing activities, this will require an assessment of likely changes in the level of the activity and the possible impact of wage and price inflation. The prices of new activities will have to be estimated using the best information currently available.
4 Assess levels of income	Careful consideration should be given to budgeted levels of income for the forthcoming year. Many councils may have no other income but the precept, but for others the budget setting process will usually be the time when decisions are taken about what level fees and charges should be set for the next twelve months.
5 Bring together spending and income plans	For many activities, spending and income decisions will be linked directly – for example if the council decides to extend the opening hours of the community hall, then it will spend more on heat and light but also generate more income from charges. However, it is an important stage of the budget process when spending plans are brought together with assessments of income to see how affordable the plans are. When doing this it is usual practice to be more optimistic about spending plans (ie to expect that the council will be able to carry out all its plans and spend as intended) and more pessimistic about income levels (ie to assume that the council might not be able to generate all the income it hopes to). Affordability will usually be judged by the impact the overall plans will have on the precept. If there is an increase in the council's budgeted net spending for next year over the current year, would this result in an increase in the precept that would be acceptable to the local population as an addition to their council tax? In fact, many councils will work the other way around: deciding first what a reasonable increase would be for the precept and then working out what the extra funds generated can be spent on.

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Process	Good practice
6 Provide for contingencies and consider the need for balances	Some councils may have absolute certainty in their spending plans for the forthcoming year. For instance, if the only significant outgoing is the clerk's remuneration and this is agreed before the start of the year, the council will know exactly how much it will spend. However, most councils will have some uncertainty in their plans, perhaps because of general factors such as inflation or changes in interest rates on cash deposits or specific things such as not knowing exactly how much firms will tender for the re-wiring work planned for the village hall. Before committing itself to its spending plans, the council should review the need for amounts to cover contingencies, in case inflation is higher than expected or works are more costly than was first thought. The amounts added to the budget should not be excessive. Councils might work to the principle that it is better to raise cash from a higher precept and not use it than to set the precept too low, and so run out of cash and run the risk of incurring an unlawful overdraft. A well-managed council will also look forward beyond the end of the year for which the budget is being set and think about whether there are any substantial commitments that it would be prudent to set aside funds for. For example, the village hall may need re-roofing in three years' time, but the council could not afford the cost from that year's budget. Instead, a balance could be built up by raising the precept for a proportion of the cost in each of the next three years. Most councils will, therefore, budget to carry forward a balance, to cover contingencies or specific spending plans. This means that in setting the budget the council will have to estimate what balance will be brought into the new year, decide what balance it wants to carry forward and charge the difference against the new year's precept (see also paragraph 2.25).

	It is possible that the council's spending plans, particularly capital expenditure, may require a level of external borrowing. Borrowing by local councils is subject to government controls and with certain limited exceptions the Secretary of State's approval is required. He or she may impose conditions in accordance with which the borrowing shall be carried out. Councils must always take advice before commencing any contractual borrowing arrangements. NALC or SLCC can provide useful guidance to assist councils in making borrowing decisions and obtaining the necessary approvals and funds. Decisions to pay outright, hire or lease should be taken prudentially and bearing the rules on borrowing in mind. Councils should also be aware of, and have internal controls in place to avoid the possibility of 'accidental' borrowing which can occur, for example, if regular payments are made at a low point in the council's cash flow cycle, i.e. at year-end, and just before the precept payment is received.
7 Approve the budget	Having determined the planned levels of spending, anticipated income and the balances needed to be carried forward for contingencies and future spending plans, the budget needs to be approved. Much of the work preceding this stage may be delegated to the RFO, but the council must approve the finalised budget. Sufficient information needs to be provided with the budget papers so that members can make a reasonable and informed assessment about the desirability and affordability of the plans for the coming year. At the same time that the budget is set, members will also approve any delegation of responsibility for spending amounts set out in the budget. For example, the budget might include amounts for paying a grant to the local youth club: authorisation might then be given to the RFO to pay the grant without having to make further reference to the council. There is no statutory requirement to publish the budget, but many councils will put a copy on the notice board once it has been approved. It must be made available on request under the Freedom of Information Act 2000.

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8 Confirm the precept	The important statutory stage of the budget process is confirming the precept that is to be raised on the district council or unitary authority for the area. The law requires that precepts be issued a month before the new financial year starts, ie by 1 March. The district council/unitary authority may ask for precepts to be issued by an earlier date to assist their setting and administration of the council tax and will normally provide assistance to local councils to ensure that everything goes smoothly. All other parts of the budget process will be timed so that the date for setting the precept can be achieved safely.
9 Review progress against the budget	Once the budget has been approved, it should be an active tool for managing the council's finances. The well-run council will have the following arrangements in place. • Progress reports prepared periodically through the year, showing spending and income to date against budgeted amounts. Care should be taken to profile the budget across the year and not necessarily assume, say, that half the budget would have been spent after six months. For instance, a significant element of spending may be grants to local organisations paid at the start of each financial year. There would then be a peak of spending in April that would not be characteristic of the other months of the year. An effective report would therefore contain projections for the full year based on spend to date and future plans. • The report is presented at each council meeting. This would provide members either with comfort that the spending plans were proceeding as hoped or with information about areas where spending was higher or lower than anticipated. In the latter case, members will be able to consider the need to amend their expenditure plans (perhaps by switching amounts from one budget heading to another that is overspent – known as 'virement'), to take steps to increase income, or to make decisions about using the funds that have been saved for contingencies. • It is good practice to change a budget that is shown by experience to be ineffective. However, changes should only be made with the authorisation of those who approved the original budget.

Some notes on Capital Budgeting

- 3.34 **Councils must only use receipts from the sale of fixed assets ('capital receipts') in excess of a de minimus value¹¹ for specified purposes.** The main purposes allowed are the repayment of external debt and the financing of capital expenditure.
- 3.35 Capital expenditure relates to the acquisition, construction and enhancement of land, buildings, vehicles, plant and equipment. Providing grant-aid for such expenditure by another body will, in many cases, also fall within the definition of capital expenditure. Capital expenditure generally involves payments of large amounts that need to be managed and properly planned over an appropriate timescale. It is unlikely that the majority of smaller councils will embark on major capital schemes. Where they do they should have a long-term capital budget or a rolling capital programme. Councils should seek technical advice from NALC or SLCC where a capital receipt is to be realised.
- 3.36 The capital budget should be reviewed annually and the impact of any capital schemes on the revenue budget assessed. This is particularly important in relation to the running costs that will be incurred when a new asset is brought into use. Where such schemes cannot be funded from capital balances the impact on borrowing and the level of future precepts should be considered.
- 3.37 Councils should take account of the revenue budget implications arising from undertaking capital projects, including the impact on audit fees.

The Cash Book

- 3.38 The most important accounting record maintained by smaller local councils will be the cash book – a register of all the payments made and receipts taken in by the council. There may be a temptation to rely on the bank statement as a record of cash transactions. However, a cash book is essential because the statements provided by the bank will not necessarily be a reliable record of the council's cash balances because:
- the bank can make errors and omissions in processing transactions – the council needs its own records to provide a check on the bank statement; and
 - there can be considerable timing differences between writing cheques to other parties and their being cashed by the bank, and between receiving income and it being credited to the council's account. The bank statement takes time to catch up with the actual cash flows of the council and cannot provide an up-to-date position.
- 3.39 The up to date cash book, therefore, provides the most accurate record of all cash and cheques received and cash payments made and cheques drawn. However, there is no prescribed format for the cash book. Depending upon the complexity of the

¹¹ Currently £10,000

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council's finances, it can be kept in a notebook, a ledger, or on a computer spreadsheet or by using a specialist accounting package.

- 3.40 Whatever medium is used for the cash book, it will normally be set out in a columnar format – the date and description of the transaction will be written in the left-hand column, and the value of the transaction entered in other columns across the page according to the nature of the receipt or payment. The headings for the columns will be chosen by the council to cover the main categories into which their cash transactions fall. Example 1 at the end of this part shows a typical layout for the cash book.
- 3.41 The basic principles for managing a cash book effectively are as follows:
- The cash book should start each year at 1 April on a fresh page or new spreadsheet, with the first entry being the cash balance brought forward at the end of the preceding financial year; if a page is filled during the course of a year, the page should be balanced off and balances carried forward to the top of the new page (see below for guidance on balancing off).
 - All entries should be dated – receipts should be recorded on the day that the cash or cheque comes into the council's possession (not when banked); payments should be recorded on the day that cash is handed over or cheques despatched (not when the cheques are eventually cashed). No cash book entries should be made for income that the council knows it should have received but has not, or monies that it should have paid over but has not or cheques written but not despatched – these are items for inclusion in the listing of assets and liabilities at year end.
 - Details of the transaction should be entered, as well as a reference to supporting documentation – the description should be sufficiently detailed to allow the cash book to be understandable if the supporting documentation were lost or destroyed, but not excessively so. Each authority will have its own referencing system for voucher numbers, linking to the bills, invoices, receipts, etc., that support the cash transaction, usually using the numbers already marked on the council's own documents and marking up new serial numbers on the documents received from other parties.
 - When recording receipts and payments, it is useful, particularly as an aid to bank reconciliation, to employ a system in which the gross receipts and payments are written down in their own columns on the left-hand side of the cash book and the receipts and payments are also then analysed on the right-hand side across the various account headings that the council has chosen. The account headings in the cashbook analysis are usually the same ones that the council has chosen for its budget. Such a planned system is helpful because:
 - it has an element of internal check in it, as, if all the entries have been made properly, the total of the left-hand side and the sum of all the columns on the right-hand side will equal each other;

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- it is particularly useful for separating out the reclaimable VAT elements of receipts and payments for the preparation of claims for reimbursement by HMRC; and
 - it also makes for easier budget monitoring as each of the columns can be ruled off and added periodically and then compared against the planned budget spend for the same period.
- Where a council has more than one bank account, it may be easier to operate a separate cash book for each account, treating transfers between accounts as receipts and payments in the same way as for transactions with other parties. However, if the council only has a straightforward savings account, there may be room in the cash book for two additional columns for the receipts and payments of the savings account.
- 3.42 What this means in practical terms is that if, for instance, the clerk had ordered goods from a supplier on credit in the council's name and spent £30 on computer supplies and £20 on cleaning materials, arranging for a cheque for £50 to be drawn to settle the bill, then the following would happen:
- The need to make the payment of £50 would be recorded on the council's list of liabilities when the goods are received.
 - Just before the cheque is put in the post, entries in the cash book would be required.
 - A gross payment of £50 would be written in the payments column on the left-hand side of the cash book.
 - Entries would be made in the appropriate columns on the right-hand side of the cash book for computer supplies and cleaning materials to the value of £25.00 and £16.00 respectively (i.e. net of 20 per cent VAT) and for reclaimable input VAT of £9.00
- 3.43 Apart from making day-to-day receipts and payments entries on a timely basis, there are two important tasks that have to be performed on the cash book:
- reconciling the cash book to the bank statement; and
 - balancing the cash book at the end of the financial year.
- 3.44 Circumstances will arise when it is necessary to cancel a cheque or a payment after it has been drawn. If the cheque has been made out incorrectly, (wrong name, date, amount, etc.) it should not be destroyed but crossed through with the word 'cancelled' written across the face and stapled to the back of the cheque book or kept safely for future reference. An entry in the cashbook should be made recording the date, the cheque number and the fact that it has been cancelled.
- 3.45 If the error is discovered after the cheque or payment has been recorded in the cashbook, it is not helpful simply to cross through the entry. Good practice is to record the cancellation as an entry in the receipts column giving all the details of number, name, date and amount together with a comment that this represents a cancelled cheque. If the cheque has already been sent, a copy of the letter to the bank cancelling the payment should be kept in the file of cancelled cheques.

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- 3.46 These cancelled cheque procedures, if followed, will allow the process of balancing the cash book (see paragraphs 3.55 - 3.60) to take place most easily.

Reporting investments

- 3.47 **Where a council holds short term investments such as deposit or savings accounts, all year-end balances must be reported in detail within the bank reconciliation and be included in the sum of Section 1, Box 8 of the annual return: *Total cash and short-term investments*.** Auditors may wish to confirm these account balances from time to time.
- 3.48 The council may also hold assets in the form of long-term investments (see paragraphs 2.29 to 2.37 on how to distinguish short-term and long-term investments). On acquisition, long-term investments should be recorded in the cash book as expenditure and therefore appear as part of the total in Section 1, Box 6: *Total other payments*. Any asset created in this way should also be recorded on the asset register at the same purchase cost. At year end the asset will also appear within the sum at Section 1, Box 9: *Total fixed assets and long term assets*.
- 3.49 Where a council acquires an investment with a fixed maturity date (for example, a three year savings bond), the investment should also be accounted for as expenditure in the year (Box 6) and also as an increase in assets and long term investment (Box 9) until its maturity. At maturity, the total (gross) proceeds should be recorded as income in Box 3. Any transaction costs should be recorded as other expenditure in Box 6. At maturity, the original acquisition value of the investment asset (which will remain unchanged over its term for the purposes of the annual return) should be removed from the total in Box 9. The accounting concept requiring restatement of long term investments as short term investments when the maturity date falls within 12 months of the accounting year-end date does not apply to local councils.
- 3.50 Like any other asset owned by the council, long-term investments should be recorded on the asset and investments register at original cost at acquisition (the purchase price) which for accounting purposes will remain unchanged until disposal.
- 3.51 It is recognised that the market value of long term investments may change over time. At each year end, the RFO should make a note on the asset register of the notional market value of each investment as at 31 March to inform readers. However, any real gain or loss compared to purchase cost will only ever be accounted for at the time of disposal when the total proceeds from the investment will be included in Box 3.
- 3.52 Any dividend or interest payments received during the year from investments should be recorded as income and reported in Section 1, Box 3: *Total other receipts*. Where the council has made a contract to the effect that any dividends or interest receivable from an investment are 'rolled up' and only paid to the council on the maturity of the investment (for example as may be the case with certain fixed term bonds), the 'rolled up' dividend and/or interest should only be reported in Box 3 if it has actually been received, that is, on the maturity of the investment.

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- 3.53 When the council has incurred expenditure by making (lawfully) a loan, grant or other financial assistance to a third party this transaction should also be recorded as an expenditure item in the cash book. Any loans made to third parties should also be added to the asset and investments register.
- 3.54 The outstanding amount of any third party loan at 31 March each year, excluding interest, falls to be reported in the sum of Section 1, Box 9: *Total fixed assets and long-term assets*. Any repayment of a loan or part of it, or any interest received should be recorded as an income item in the cash book when received and reported in Section 1, Box 3: *Total other receipts*. This receipt will also be reflected as an increase in Section 1, Box 7: *Balances carried forward*. Any repayments of loan principal should reduce the amount of the loan shown as outstanding on the asset and investments register.

Reconciling the cash book to the bank statement

- 3.55 Bank statements¹² are important documents as they are evidence provided by an independent party of the state of the council's cash balances. They contrast with the cash book, which is the council's own record of its cash position. It is consequently an invaluable exercise to compare the balances on the bank statement with the balance in the cash book at any particular date and understand the reasons for any differences between them. This will reveal whether there are any errors, omissions or discrepancies in either the bank records or the cash book (for example cheques drawn properly have been known to be altered by recipients before being banked.)
- 3.56 Bank reconciliations should be performed regularly, perhaps quarterly or monthly. Whenever it is done, the reconciliation should cover each of the council's bank accounts. Most commonly, councils will operate a current account through which most transactions are made, and possibly one or more deposit accounts.
- 3.57 The bank reconciliation is a key tool for management as it identifies available funds at a specific moment in time which aids good decision making, particularly when there are competing priorities. The year-end bank reconciliation is particularly important as it will 'prove' the total cash and short-term investments balance shown on the council's annual return (Section 1, Box 8). As bank statements may be made up to different dates in the month, care should be taken, particularly at year end, to ensure that the statement being reconciled includes balances as at 31 March.
- 3.58 Some councils will carry out a reconciliation every time they receive a bank statement, which is good practice as it identifies bank errors early on. It is for each council to decide how regularly it wants to receive the assurance that a successful reconciliation can provide. Reconciling the cash book to bank statements should be reported to members, and the full reconciliation made available for their scrutiny each time it is done. Approval of the bank reconciliation by the council or the chair of finance or

¹² Or statements from whatever institution the council uses as its primary bank account, for example post office or building society.

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another council nominee is not only good practice but it is also a safeguard for the RFO and may fulfil one of the councils internal control objectives.

- 3.59 There are a limited number of reasons for differences between bank statements and the cashbook, and most councils will be able to use a standard layout for the bank reconciliation. The common reasons are:
- unpresented cheques – payments are recorded in the cash book when the authority commits itself to making them, usually by handing over a cheque, putting a cheque in the post or completing the instructions for an automated payment; the balance on the bank account will not reduce until several days later when the cheque or instruction is received by the bank and processed. Unpresented cheques therefore need to be deducted from the bank statement balance in the reconciliation;
 - payments into the bank which are outstanding (sometimes referred to as ‘cash in transit’) - receipts are recorded in the cash book when they come into the possession of the council; however, they will not be recognised on the bank statement until after cash is banked or cheques are cleared. Payments into the bank which are outstanding from the bank statement therefore need to be added to the bank statement balance in the reconciliation; and
 - there may be transactions in the bank statement that are not recorded in the cash book – this will particularly apply to interest payable and bank charges, which might be advised to the council for the first time through the bank statement. The bank statement may also show up direct debits, standing orders and other automated payments that have been omitted from the cash book. None of these is strictly an item for the reconciliation, however. Instead, the cash book should be updated to record all of these transactions, and the resulting balance is then brought into the reconciliation.
- 3.60 A standard layout for financial year-end bank reconciliation would look something like this (although the model can be applied for reconciliations carried out at any time of year).

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Bank Reconciliation		Financial year ending 31 March 20XX																																							
Council Name																																									
Prepared by _____ (Name and role (Clerk/RFO etc)) Date _____																																									
Approved by _____ (Name and role (RFO/Chair of Finance etc)) Date _____																																									
<table border="1"> <thead> <tr> <th>Balance per bank statements as at 31 March 20XX</th> <th>£</th> <th>£</th> </tr> </thead> <tbody> <tr> <td>eg Current account</td> <td>1,000.00</td> <td></td> </tr> <tr> <td>High interest account</td> <td>3,000.00</td> <td></td> </tr> <tr> <td>Building society premium a/c</td> <td>10,000.00</td> <td></td> </tr> <tr> <td>Petty cash float</td> <td>10.00</td> <td></td> </tr> <tr> <td></td> <td></td> <td>14,010.10</td> </tr> <tr> <td>Less: any un-presented cheques at 31 March (normally only current account)</td> <td></td> <td></td> </tr> <tr> <td>Cheque number 000154</td> <td>(60.00)</td> <td></td> </tr> <tr> <td>000157</td> <td>(18.00)</td> <td></td> </tr> <tr> <td>000158</td> <td>(2.00)</td> <td>(80.00)</td> </tr> <tr> <td>Add any unbanked cash at 31 March</td> <td></td> <td></td> </tr> <tr> <td>eg Allotment rents banked 31 March (but not credited until 1 April)</td> <td>50.00</td> <td>50.00</td> </tr> <tr> <td>Net bank balances as at 31 March 20XX</td> <td></td> <td>13,980.00</td> </tr> </tbody> </table>			Balance per bank statements as at 31 March 20XX	£	£	eg Current account	1,000.00		High interest account	3,000.00		Building society premium a/c	10,000.00		Petty cash float	10.00				14,010.10	Less: any un-presented cheques at 31 March (normally only current account)			Cheque number 000154	(60.00)		000157	(18.00)		000158	(2.00)	(80.00)	Add any unbanked cash at 31 March			eg Allotment rents banked 31 March (but not credited until 1 April)	50.00	50.00	Net bank balances as at 31 March 20XX		13,980.00
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3.61 To prepare a bank reconciliation:

- enter the balances from each of the bank statements for the chosen date at the head of the page;
- review the bank statements for transactions that have not been recorded in the cash book, such as interest and bank charges, and make the appropriate cash book entries;
- balance off the cash book (see below) and enter the resultant balance at the foot of the page;
- identify the cheques that have been recorded as drawn in the cash book but have yet to show up on the bank statement – this will usually be the cheques that have been drawn on the days immediately prior to the bank statement date, but there may be others where the payee is taking a long time to present the cheque at its bank;
- identify the cash collected or cheques received that have been entered on the cash book but not banked in sufficient time for the bank to have processed them and add them to the bank balance;
- if the calculation (bank balance – unpresented cheques + payments into the bank outstanding) does not then equal the cash book balance, an in-depth analysis of the bank statement and cash book may be necessary to discover the reason for the unreconciled difference; and
- the bank reconciliation should always be balanced to the penny – you cannot stop looking for reconciling items once the difference has been reduced to a tolerable amount, as this difference might actually be comprised of two significant undiscovered errors (one positive and one negative) that just happen to cancel each other out.

3.62 Where a council has more than one bank account, each account should be balanced to the cash book, including any inactive accounts that may be open. In these circumstances there will be a third category of possible reconciling items – transfers between accounts that have been requested but not yet processed by the bank.

3.63 Practitioners should note that transfers between bank accounts are neither receipts nor payments. Total transfers will sum to zero and so must be excluded from in the annual totals of receipts and payments in the cashbook and from Boxes 3 and 6 of section 1 of the annual return.

Balancing the cash book

3.64 The process of 'balancing the cash book' involves putting new entries in the cash book so that the totals in the receipts and payments columns equal each other. However, this equalisation is carried out (paradoxically) in order to confirm the differences between the two.

3.65 The purpose of balancing the cashbook is explained as follows (and demonstrated in Example 1 at the end of this part of the guidance):

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- The first step in balancing the cash book is to add up the figures in the receipts and payments columns, including the brought forward cash figure – in the example this gives totals of £2,119.12 and £784.99 respectively.
- As a cross check, the totals in the receipts and payments columns on the left hand side should be reconciled to the detailed receipts and payments entries on the right-hand side. This requires that the brought forward cash balance is ignored in the totals for the left-hand side (i.e. in the example, the total for receipts would be reduced from £2,119.12 to £1,110.37, the receipts actually taken in the year) and that the right-hand totals add back in the VAT elements that have been separated out.
- Looking at the totals for the receipts and payments columns on the left-hand side, the next step is to work out the amount that would bring whichever is the lower of the two figures (£784.99) up to the value of the higher (£2,119.12). In this example, the difference is a net receipt of £1,334.13. This figure is entered under the lower of the two figures as 'balance to be carried forward'. (This figure will become the 'balance brought forward' which opens the next financial period. Practitioners should always check that the opening balance in the cashbook is identical to the 'balance to be carried forward' from the previous period.)
- When the balance carried forward is added to the total figure (in this case under the payments column) it should equal the total for the other column - £2,119.12. The cash book is thereby balanced, and is ruled off to start a fresh period of accounting. The figures that balance are not very meaningful in themselves – it is just important that they are the same.
- To complete the process, the balance carried forward at the end of the old period is entered as the first item in the new period of accounting. This is done by entering the balancing figure (£1,334.13) in the other column to the one that was used in the balancing process. This figure will then represent the cash balance carried forward to the new period, either cash-in-hand (if in the Receipts column) or cash overdrawn (if in the Payments column). It is the figure that is used as the cash book balance in the bank reconciliation.

Accounting for Fixed Assets

- 3.66 This section covers the arrangements in respect of the acquisition, maintenance and eventual replacement of those items of a capital nature where values tend to be high and which have a useful life of more than one year. These items are usually described as fixed assets (or more frequently now as non-current assets) and comprise the sum of land, buildings, equipment, plant and vehicles etc.
- 3.67 **Long-term investments (see paragraphs 2.29 to 2.37) are assets and must also be accounted for in the asset register. See paragraph 3.47 to 3.54 on how to report long-term investments.**
- 3.68 **Fixed assets acquired in any year must be added to the asset register for management purposes. For accounting purposes, however, acquisitions and**

disposals of fixed assets must be treated as any other purchase or sale and recorded as part of annual receipts or payments, expenditure or income.

3.69 Once recorded on the asset and investments register, the recorded value of assets and investments must not change from year to year until disposal.

Commercial concepts of depreciation, impairment adjustments, etc. are not appropriate for local councils. For reporting purposes therefore, the 'book' value of fixed assets will stay constant throughout their life until disposal.

3.70 If assets are not being managed properly, the Council is exposed to the risk of financial loss relating to:

- improper asset management – without the right management information, outdated patterns of use may run on unchallenged or unnoticed;
- improper asset usage and maintenance – assets may not be fit for purpose, be underused or so out-of-date as to be incapable of satisfactory modernisation. Equally they may be capable of alternative, additional or more intensive use or be readily saleable. These opportunities may be missed where no comprehensive information on assets is available; and
- asset ownership – the continued ownership of assets may be overlooked altogether and risks unmanaged.

3.71 These risks are most likely to be realised when information is poor; in particular where information about assets is not available or access to information about assets is denied by being out-of-date or non-existent. The risk of financial loss can be greatly reduced by setting up an asset register which holds all the information needed.

3.72 An asset register is the starting point for any system of financial control over assets as it:

- facilitates the effective physical control over assets;
- provides the information that enables the council to make the most cost effective use of its capital resources;
- ensures that no asset is overlooked or underutilised and is therefore used most efficiently;
- pools all the information available about each asset from across the organisation and makes it available to every part of the organisation;
- provides a record of the sources of evidence used to support the existence and valuation of assets to be covered by insurance;
- supports the annual return entry for capital assets by collecting the information on the cost or value of assets held; and
- forms a record of assets held for insurance purposes.

3.73 The key information needed in the asset register is:

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- dates of acquisition, upgrade and disposal (it is useful to keep a record of disposed assets as an asset management tool);
- costs of acquisition and any expenditure which increases the life of the asset;
- if proxy cost is used for first valuation, the method used for valuation and details of professional advice received ;
- useful life estimate;
- location;
- responsibility (it may be appropriate to assign responsibility for each asset to members of staff);
- present use and capacity, for example in terms of site area, internal floor areas, and measures of occupancy and/or usage;
- corresponding periodic measures of usage or occupation;
- any available indications of asset value and condition; and
- charges for usage or occupancy.

- 3.74 Most assets will be first recorded in the asset register at their actual purchase cost. In some cases the purchase cost may not be known and a proxy cost should be substituted. A proxy cost is a value for the asset which is estimated by the council based on external advice. Councils may apply the insurance value of the asset at the time of first recording as a proxy. Whether actual or proxy cost is used, for accounting purposes the first recorded value of the asset will not change throughout its life.
- 3.75 Whatever asset valuation basis is applied, the method used (actual or proxy) should be recorded in the asset register. If for some reason the council decides that the basis of valuation is to be changed, the change should be applied consistently to all fixed assets. In such an event, the value shown in Box 9 of the annual return for the previous year should also be changed to the same new basis and clearly marked as 'RESTATED'. The council should provide a justification and explanation for the change to the external auditor.
- 3.76 In the special case where a local council receives an asset as a gift at zero cost, for example by transfer from a principal authority under a community asset transfer scheme, the asset should be included in the asset register at cost. However, it is strongly recommended to ensure that such assets are always disclosed in Section1, Box 9 of the annual return councils should assign a nominal one pound (£1) value as a proxy for the zero cost. The use of the £1 proxy is particularly important in cases where a council operates an asset registration system that requires a positive value for every asset. Any costs of bringing gifted assets into productive use should be expensed as revenue items.
- 3.77 Many councils own assets that do not have a functional purpose or any intrinsic resale value (for example, a village pond or war memorial). These assets are often referred

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to as 'community assets'. Councils should record community assets in the assets register in the same way as gifted assets (see 3.76 above).

Preparing the annual return

3.78 Section 1 of the annual return represents the statutory accounting statements that councils are required to prepare, to have audited and to publish. If the books of account have been kept in good order during the year and the cash book has been balanced and reconciled to the bank statement at the 31 March, then the Return should be straightforward to prepare.

For councils with gross income or expenditure (whichever is the higher) in any year under £200,000.

3.79 For councils with turnover of less than £200,000 the annual return should be prepared on a receipts and payments basis, or, if the council so wishes, it may be prepared on an income and expenditure basis (in which case see next section).

3.80 The receipts and payments basis requires councils only to consider their actual bank and cash transactions. The entries for the annual return will usually be taken straight from the summary totals in the cash book.

3.81 For example, if the council whose cash book is shown in Example 1 had no further transactions for the year, then its annual return would be compiled like this.

		This year £	Last year £	Notes on compilation from Example 1 cash book
1	Balances brought forward	1,009		This should be the brought forward figure shown at the head of the cash book for this year – it will equal the last year figure in line 7 of the Return.
2	(+) Annual precept	600		The total in the Precept column of the cash book.
3	(+) Total other receipts	510		The total in the Receipts column (£2,119.12), less the balance brought forward (£1,008.75) and the annual precept (£600).
4	(–) Staff costs	(200)		The total in the Clerk's salary column
5	(–) Loan interest/capital repayments	NIL		

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		This year £	Last year £	Notes on compilation from Example 1 cash book
6	(–) Total other payments	(585)		The total in the Payments column (£784.99) less staff costs (£200).
7	(–) Balances carried forward	1,334		The sum of the above entries
8	Total cash and investments	1,334		As line 7 – no other balances held but cash
9	Total fixed assets	NIL		
10	Total borrowings	NIL		

For councils with gross income or expenditure (whichever is the higher) in any year between £200,000 and £6.5 million, or for those electing to report income and expenditure

- 3.82 **For councils with annual turnover between £200,001 and £6.5 million the annual return must be prepared on an ‘income and expenditure’ basis.** In income and expenditure accounts, the transactions for the year comprise all those instances in the twelve months where the council has received economic benefits or given others economic benefits (irrespective of the year in which they are paid for).
- 3.83 For example, a council has its owned offices re-roofed in March but the builders do not issue an invoice until April and the council does not settle the bill until May. The cash book will, therefore, record a bank outgoing in May of the new financial year. However, the council will have received the benefit of the works before the end of the financial year in March and have an obligation to pay the builders, even though their invoice has not arrived to confirm the exact amount due. In order to show the proper financial position of the council for the old year, expenditure should be recognised in March.
- 3.84 In contrast, someone might put down a refundable deposit in February on a booking for the hall in June. The cash book would record a cash receipt in February. However, the council will not be providing any economic benefits to the booker (i.e. use of the hall) until June of the new financial year, and would be unwise to spend the cash receipt until the event takes place. The receipt should therefore not be counted as income in the old financial year but recorded as a prepayment only to be accounted for as income in the new financial year.

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- 3.85 Income and expenditure accounting thus gives a more sophisticated presentation of a council's true financial position, focusing on the balance of economic benefits that it has under its control, rather than just its bank balance.
- 3.86 Very few councils will actually maintain accounting records on an income and expenditure basis. The cash book will be the main focus for day-to-day receipts and payments and the main source for reconciliation to the bank statement, and remains the most important control over the accounting system. Subsidiary records will be kept of the council's debtors (people who owe the council) and creditors (people the council owes) based on invoices, but transactions will only be made in the cash book for this activity when cheques and cash are actually received or paid. This means that a special exercise is required at the end of each financial year to convert the receipts and payments record represented by the cash book into the income and expenditure account required by section 1 of the annual return.
- 3.87 The exercise is a little complicated because care has to be taken to make adjustments for both ends of the financial year. For example, as well as adding in amounts owed at the end of the year that are not in the cash book, payments that are in the cash book but relate to amounts owed at the end of the previous year have to be taken out. The adjustments required comprise the following.

Debtors: situations where the council has provided goods or services before the end of the year, but has not yet been paid for them by 31 March.	To convert 'receipts' into 'income' take the cash book totals for receipts and: • <i>deduct</i> the amount of debtors brought into the calculation of income for the previous year; and • <i>add</i> the amount of debtors outstanding at the end of this year.
Receipts in advance: situations where the council has received cash before the year end, but has not yet provided the relevant goods and services by 31 March.	To convert 'receipts' into 'income' take the cash book totals for receipts and: • <i>add</i> the amount of receipts in advance excluded from the calculation of income for the previous year; and • <i>deduct</i> the amount of receipts in advance held at the end of this year.
Creditors: situations where the council has received goods or services before the end of the year, but has not yet paid for them by 31 March.	To convert 'payments' into 'expenditure' take the cash book totals for payments and: • <i>deduct</i> the amount of creditors brought into the calculation of expenditure for the previous year; and • <i>add</i> the amount of creditors outstanding at the end of this year.
Deferred Grant: arises only in	To convert 'receipts' into 'income' take the cash

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situations where the council receives a grant before the year end but some or all of the grant has not been spent by 31 March and the grant conditions require repayment of any balance not spent on the specified purpose for which the grant was given.	book total of receipts and : • <i>add</i> the amount of deferred grant excluded from the calculation of income for the previous year; and • <i>deduct</i> the amount of grant held at the end of this year.
Prepayments: situations where the council has paid cash before the year end, but has not yet received the relevant goods or services by 31 March.	To convert 'payments' into 'expenditure' take the cash book totals for payments and: • <i>add</i> the amount of prepayments excluded from the calculation of expenditure for the previous year; and • <i>deduct</i> the amount of prepayments made at the end of this year.
Stock: consumable goods (for example, bar supplies) purchased before the end of the year but which have not been used by 31 March.	To adjust for stock in expenditure take the cash book totals for payments and: • <i>add</i> the amount of stock brought forward as an asset from the previous year; and • <i>deduct</i> the amount of stock held at the end of this year.
Provisions: any other situation in which the council has an obligation to make a payment, but it is uncertain when the payment will be due (for example, a claim has been made for compensation against the council that is likely eventually to result in the council making recompense). (NB. This is only likely to occur in rare circumstances for councils.)	To adjust for provisions in expenditure take the cash book totals for payments and: • <i>add</i> the value of any provision that needs to be made for events taking place in this year; and • <i>deduct</i> the value of any provisions made in previous financial years and brought forward, to this financial year and where payment has been made to settle the obligation and those no longer required.

3.88 Councils will need to have effective arrangements in place to identify and calculate the adjustments needed. These will include:

- deciding on a level of materiality for adjustments – income and expenditure needs to be shown fairly, but excessive accuracy is not beneficial. For instance, most councils will have utilities bills that include prepayments for standing charges and payments in arrears for energy consumption that strictly should be adjusted for into their appropriate years. As this is a regular item of expenditure it is not usually worth apportioning individual bills across financial years, but just ensuring that four bills (if payable quarterly) are charged each year;

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- making sure that a record is retained of the adjustments that were made in preparing the income and expenditure accounts for the previous financial year;
- examining entries in the cash book before 31 March for possible receipts in advance and prepayments and entries after 31 March for possible debtors and creditors;
- examining invoices after 31 March for possible debtors and creditors;
- assessing the value of stock at the 31 March (having a formal stocktaking if the council has a proper stock control system); and
- considering whether the council has any other obligations arising from events that took place before 31 March that mean it will not be able to avoid making a payment at some time after 31 March.

Notes applicable to all local councils

3.89 Compilation of the annual return from the cash book might not always be straightforward. The following table discusses some difficulties that might arise with each line of the return.

1 Balances brought forward	The balance brought forward at the start of the current year should match the balance carried forward at the end of the previous year. However, it is always possible that errors and omissions can be found in the accounts, even after an audit. If there were mistakes in the previous year's accounts, then the current year Return should be prepared as if the mistake had not been made – ie the last year figures for the balance brought forward should be the corrected figures and not those published last year. In this event, last year's column must be marked 'RESTATED' and a note prepared for the auditor explaining the mistake and how it has been corrected this year.
2 (+) Annual precept	There will be very few occasions when the precept on the district council is not paid in full before the end of the relevant year or is paid early when 31 March falls on a weekend or bank holiday.
3 (+) Total other receipts	This figure will simply be the total cash receipts taken by the council in the year, reduced by the value of precept payments recorded in the preceding box. If the accounting statements is being prepared on a receipts and payments basis, VAT charged on goods and services provided by the council should be included, even though the tax is payable to HM Revenue and Customs. Some adjustments may be necessary where the council has more than one bank account – transfers between bank accounts (eg between current and deposit account), would show up as receipts and

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	payments for the individual accounts in the cash book, but they are not receipts and payments for the council as a whole. Both sides of a transfer between the council's own bank accounts should be ignored when adding up receipts and payments for the year.
4 (–) Staff costs	This figure comprises all payments made in relation to the employment of staff. Include employment expenses which are benefits (mileage, travel, etc.) but not items of reimbursement of expenses for postage, stationery or other outlays made on behalf of the council. Where the council makes deductions for PAYE and National Insurance and pays employer's contributions for NI and pensions, then Staff costs should include payments to HM Revenue and Customs and any pension contributions.
5 (–) Loan interest/capital repayments	Most councils will not have any borrowings and will not then have interest or capital repayment transactions. For those that have borrowed from the Public Works Loans Board (PWLB), the figure will be the payments made in the year in accordance with the PWLB repayment schedule. If a council goes overdrawn at the bank, then any interest or charges paid as a result of the overdraft should be included under this heading. Bank charges other than those arising as a result of temporary borrowing should be included in Total other payments in line 6.
6 (–) Total other payments	This figure should simply be the total cash payments made by the council in the year, reduced by the value of staff costs and loan interest and capital repayments recorded in the preceding two boxes. If the accounting statements are being prepared on a receipts and payments basis, VAT on goods and services acquired by the council should be included, even though the tax is reimbursable by HM Revenue and Customs. Some adjustments may be necessary where the council has more than one bank account and transfers have been made between them – see Total other receipts above.
7 (=) Balances carried forward	This should be the total of all the preceding entries, taking care to get the + and – entries the right way round. It should also match the balance carried forward on the cash book at the end of the year.

Two notes on VAT

- 3.90 For councils reporting on the receipts and payments basis, the amount of VAT charged to 'customers' and the VAT refund made by HMRC will be included in line 3

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(other receipts); the amount of VAT paid to suppliers and any paid to HMRC will be included in line 6 (other payments).

- 3.91 For councils reporting on an income and expenditure basis the amounts of VAT collected from customers, paid to suppliers, and payable to, or repayable by, HMRC will be posted to a creditor account which will result in a balance due to or from HMRC. This balance will be included in Creditors or Debtors as appropriate; in this case the only value of VAT to be included in the annual return figures will be any that is to be written off as irrecoverable (usually due to a partial exempt position on VAT).

Moving from Receipts and Payments to Income and Expenditure

- 3.92 Having prepared a receipts and payments account from the cash book, the receipts and payments account needs to be converted into an income and expenditure account by the adjustments set out in paragraph 3.78. Suppose that the council in Example 1 had the following circumstances.

Debtors	• The hall booking fee of £75 received on 8 April 20XX was paid in arrears for an event that took place on 30 March 20XX before the year start and had been accounted for as a debtor in last year's income figure. • A hall booking fee of £200 for an event held on 14 March 20YY was not paid until 30 April 20YY after the year-end.
Receipts in advance	• Hall booking fees of £300 were taken before 1 April 20XX for events that were to take place after 1 April and these were accounted for as receipts in advance in last year's income and expenditure figure. • The hall booking fees of £150 received on 24 May 20XX were for an event that did not take place until April 20YY in the following financial year.
Creditors	• The payment of £45 for the repair of a window made on 22 April was for work carried out before the start of the year and had been accounted for as a creditor in last year's income and expenditure figures. • No payment has yet been made for the replacement of a door in February 20YY – an invoice received after the year-end confirms that £56 is payable.
Prepayments	• Before 1 April 20XX the council paid £220 in advance for a service cover agreement on its kitchen equipment for the year starting on 1 April 20XX. • The grant of £250 paid to the sports association on 17 May was to cover the period running from June 20XX to May

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Stock	• 20YY, extending beyond the end of the financial year – one sixth of the grant (around £40) is a prepayment for amounts due after 31 March 20YY. • Checks of the levels of stocks of cleaning products in the village hall showed that £120 was held at 31 March 20XX and £70 at 31 March 20YY
Provisions	• In July 20XX there was an accident in the village hall that resulted in slight injury – the council's solicitor estimates that the council will end up with a bill for compensation of £300 that will not be covered by insurance. • In November 20XX, an earlier claim for accident compensation was settled without the council having to pay a penny – however, a provision had been made in the previous year's income and expenditure account for £100 for a likely settlement.

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The following adjustments to the receipts and payments account would then be necessary.

B O X		R + P £	Previous year adjustments £	Current year adjustments £	I + E £	Notes on compilation from the receipts and payments account
1	Balances brought forward	1,009	(30)	-	979	This should equal the last year figure in line 7 of the Return and the adjustment requires replacing the R+P amount with last year's I+E figure
2	(+) Annual precept	600	0	0	600	
3	(+) Total other receipts	510	(75) 300	200 (150)	785	Debtors adjustments Receipts in advance adjustments
4	(-) Staff costs	(200)	0	0	(200)	
5	(-) Loan interest /capital repayments	0	0	0	-	
6	(-) Total other payments	(585)	45 (220) (120) 100	(56) 40 70 (300)	(1,026)	Creditors adjustments Prepayments adjustments Stock adjustments Provisions adjustments (Note – as the payments figure is presented as a negative, deductions from payments are shown as positive figures and additions as negatives.)
7	(=) Balances carried forward	1,334	0	(196)	1,138	The sum of the above entries

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- 3.93 As a check that the income and expenditure figures have been properly prepared, councils should agree the balance carried forward in Box 7 back to the assets and liabilities held at 31 March that have been taken into account in the conversion. Using the figures above:

	£
Balance carried forward	1,138
Cash (positive if credit, negative if overdrawn)	1,324
Debtors (positive figure)	200
Receipts in advance (negative figure)	(150)
Creditors (negative figure)	(56)
Prepayments (positive figure)	40
Stock (positive figure)	70
Provisions (negative figure)	(300)
	1,138

- 3.94 The other entries in Section 1 of the annual return will be compiled separately from the income and expenditure exercise.

Box 8: <i>Total cash and short-term investments</i>	For most councils, the value in this Box will be the figure carried forward from the end of year balanced cash book that was taken into account in the bank reconciliation. Investments in the form of bank deposit or other short-term saving accounts must be added to the total in Box 8 and shown on the bank reconciliation.
Box 9: <i>Total fixed assets and long-term investments</i>	This should be the value of all fixed (non-current) assets recorded in the asset register including any investments For instance, the council might have invested surplus funds in Government securities, and the purchase of these would have been accounted for as a payment out of the cash book, suggesting that the council had spent money rather than invested it. In order to give a fair view of the council's finances, the purchase cost of these investments (as recorded in the schedule of assets and investments) should be included in this line.

Box 10: *Total borrowings*

This should be the amount outstanding at 31 March each year. If a council has borrowings, they will usually be in the form of longer-term loans from the PWLB. The capital value of instalment finance, including HP or leases which have not been classed as borrowing by DCLG, should not be included here. The amount borrowed at 31 March should be easily calculated by reference to official loan schedules. This amount should include the current portion of long term debt.

- 3.95 The annual return requires supporting documentation for the accounting statements in section 1 to be provided to the auditor. Because of its importance as confirmation that the council's books of accounts are supported by the bank's records, the most important document to be provided is the year-end bank reconciliation. The reconciliation should be prepared to at least the level of detail shown in the example above, so that the auditor can appreciate the difference between the year-end cash book and bank account balances and the nature of the items that reconcile that difference. The council should carry out a separate reconciliation for each bank account operated by the council although the results may then be summarised.
- 3.96 The other supporting documentation required to accompany the annual return is a brief but complete explanation of significant year-on-year variations between the figures on the return. This is because the auditor will be considering the reasonableness of the return using a technique called analytical review. The auditor will look at the council's figures for last year and, using their accumulated knowledge about the council and of the influences over the council this year, develop an expectation for what this year's figures should be. This expectation will be compared with the actual figures and, where they are significantly different, the auditor may have some concern that the accounts might be wrong. Councils should remove this doubt by providing explanations for the differences between this year and last year.
- 3.97 For example, a reasonable expectation may be that staff costs should rise each year only by the level of wage inflation. Thus, if the clerk's remuneration had risen, say, from £2,500 to £2,575 year on year (3 per cent), this could reasonably be assumed to be attributable to a cost of living increase. However, if the remuneration had risen to £2,900, i.e. by 16 per cent, then the auditor would need reassurance that a mistake had not been made in recording staff costs. If the explanation was that the council had implemented tighter new financial procedures that required the clerk to work more hours a week, this should be set out in a note to the auditor.
- 3.98 The important thing about such information notes is that they should remove doubts about possible errors or omissions, and they, therefore, should explain fully the difference. For example, a note stating simply that staff costs had risen 20 per cent because the clerk's hours had risen 20 per cent would still leave open the question as to why the hours had risen this year.

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- 3.99 It is impossible to give definitive guidance on what 'significant' year-on-year variations are by, for example, giving a standard percentage figure below which movements do not need to be explained. It might sometimes be significant that there has been no change between this year's and last year's figure. For instance, if a council's other payments were high in one year because of exceptional expenditure on re-roofing the offices, then the auditor would expect in the following year that payments would fall back to the usual level rather than remain at the same high value as the previous year. 'No change' in the accounts would then be significant and need explanation. However, as a general 'rule of thumb' any increase of plus or minus 10 to 15 per cent or more in any line item should be formally explained as a matter of course as should any expenditure that has either started or ceased.
- 3.100 The test for significance is then usually whether, if the figures were amended to leave an item out, someone reading the annual return would get a different idea about how much the council had spent or how much income it had generated in the year, enough to think it had done better or worse than it actually had.
- 3.101 In deciding what needs commenting on, councils should think about noting the following:
- One-off items of spending or income from last year and this year.
 - Regular items of spending and income where the relevant activity (for example the number of hall bookings) has risen or fallen between the two years or where prices have not changed in line with inflation (for example a price freeze on charges for hall rentals).
 - Items of spending and income that used to be regular but which were made for the last time last year and do not feature in the current year (for example a grant to a sporting association that went out of existence).
 - Items of spending and income that were made for the first time in the current year and will be made regularly in future years (for example running expenses for a newly opened one-stop shop facility).

Audit Notices and the presentation of the annual return

- 3.102 **The Act and the regulations contain important provisions that open the accounts of a council up to public scrutiny as councils are custodians of public funds. Members of the public as well as local councillors have rights to satisfy themselves about the regularity of a council's finances. They may ask questions about and make objections to particular items of account.** For more detailed information about the rights of electors please refer to the Audit Commission publication *Council Accounts - a Guide to Your Rights*.
- 3.103 These opportunities for scrutiny cover both the books of account and the accounting statements, but are restricted to particular times. Although councils are not required to open their books on request, increasingly there is a move towards them doing so in pursuit of demonstrating openness and transparency.
- 3.104 **The particular things that the council must do to provide for the exercise of electors' rights in relation to the accounts are:**
- **advertise the rights of the public at the appropriate times;**
 - **allow public inspection of section 1 of the annual return and the supporting books of accounts and other documents once the return has been drafted; and**
 - **publish sections 1 and 2 of the annual return after it has been audited, together with the auditor's report (section 3), and make available other relevant documents.**
- 3.105 The council's appointed external auditor is the person responsible for setting the date of the commencement of the audit period from which time electors may exercise their rights. This date will be prominent in the auditor's notice of audit which is sent to the council in order that it can be advertised by display in a prominent place. **Similarly, a public notice that the auditor's certificate, which effectively closes the audit for any particular year, when received must be displayed.** The auditor's certificate of closure is in section 3 of the annual return.
- 3.106 **The council must carry out its duties in accordance with the law.** As with all aspects of the law, there is scope for interpretation as to what the provisions of the regulations require. A common issue arising is whether councils have any discretion to restrict access to the books of accounts if they suspect that the interested party is seeking to get hold of personal or commercially sensitive information. Personal information held by a council, for example, is protected under s15 of the Act. This protection does extend to personal details of staff and their individual salaries and deductions. If there is uncertainty, the external auditor may be requested to exercise the authority to rule on what is personal information.
- 3.107 Councils should read the requirements of the Accounts and Audit Regulations for themselves, and use this guidance only to provide support for the conclusions they

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arrive at about what the Regulations require the council to do. Where there is doubt, councils should consider taking legal advice.

- 3.108 The external auditor is not responsible directly for enforcing the provisions relating to public scrutiny. However, as their audit might not be properly carried out if the responsibilities of others have not been met (for example a failure to advertise the audit), they may be willing to comment on issues that the council is having difficulty resolving.
- 3.109 The following timetable summarises the tasks that a typical council will need to schedule in order to prepare the accounts for approval, inspection and publication in accordance with the Accounts and Audit Regulations.

Step	Task	Comments
1	Arrange for the council to receive the documents needed to prepare the annual return	Likely tasks include: • requesting bank statements for 31 March for all bank accounts; • arranging for savings account books to be made up to date for 31 March; and • obtaining written confirmation of loans and investments at 31 March, including interest for the year.
2	Close, balance and reconcile the cash book and update the schedule of assets and liabilities	This should be done as soon as practicably possible after the end of the financial year, and certainly in good time for the council to approve section 1 of the annual return by the statutory date (see step 3).
3	Draw up Accounting statements and Annual Governance Statement	The latest date for approval (see step 6) of the annual return is 30 June. Ensure you have a copy of the current year annual return completed in good time and make arrangements for a full council meeting to approve the accounts.
4	Receive confirmation of the date of audit with the auditor	The external auditor will appoint the date when local electors can exercise their right to ask questions about the accounts or to object to any item of account and to notify the council. The council has no official role to play on this date, but needs to know the date as steps 6 and 7 have to be scheduled to be completed before it.

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Step	Task	Comments
5	Display a notice of public rights	In preparation for step 7, councils are required to display a notice (or notices) in a conspicuous place(s) in the council's area setting out: • the dates of the 20 working day period during which the accounts and other documents will be available for inspection; • the place at which, and the hours during which, they will be available; • the name and address of the auditor; • the rights conferred on the public by sections 14 and 15 of the Act (public inspection of accounts and right to challenge); and • the appointed date for audit. The notice is must be displayed for at least 14 days immediately before the commencement of the inspection period (step 7). Therefore, as step 7 has to be started at least 20 working days before the auditor's appointed date, this means that the notice should be posted in a conspicuous place or places at least six weeks before the appointed date (and longer if there are any public holidays during the inspection period). It is important that the council ensures that the notice is posted promptly and it is good practice for the notice to remain displayed for the whole period up to the date of audit. The council must give a public assurance as part of the annual governance statement in the annual return that this step has been carried out during the financial year.

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Step	Task	Comments
6	Submit the completed annual return to the council for approval	Under Regulation 13(2) the RFO must sign and date the accounting statements, income and expenditure account and statement of balances, or record of receipts and payments, and certify that it presents fairly the financial position of the council at the end of the year to which it relates and its income and expenditure or that it properly presents receipts and payments, as the case may be, for that year. The certification is already set out in section 1 of the annual return and just needs signing by the RFO confirming that the accounting statements is correct. This certification is required from the post holder at the time of approval. After the RFO certification, regulation 13(3) requires that the accounts must be approved by a meeting of the full council and that the person presiding at that meeting must sign and date the accounts to signify the completion of the approval process. Again, there is space on section 1 of the annual return to record the council's resolution and the presiding member's signature. It is sensible to do this before the accounts are made available for inspection in step 6, but this is not a statutory requirement. However, regulation 13(3) requires that this must be done as soon as reasonably practical and by 30 June at the latest.

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Step	Task	Comments
7	Make the accounting statements and other documents available for inspection	Under Regulation 15 the accounts and all books, deeds, contracts, bills, vouchers and receipts relating to them must be made available for inspection by interested parties for 20 working days before the auditor's appointed date. The council can require that interested parties give reasonable notice that they wish to inspect records and do not have to grant immediate access on request. The public are entitled to make copies of any of the documents available for inspection. This can be the most contentious part of the annual accounts and audit process, where allegations can arise that documents are not being made available or that interested parties are taking advantage of the inspection period. Section 15 (4) of the Act prevents a council from releasing certain personal information. However, there is a presumption that the council will be open and transparent with information about its activities, so where a council wishes to withhold information, legal advice should always be sought. In relation to personal information, the auditor has legal powers to determine whether information should be released. The full inspection period must be completed before the auditor's appointed date for audit.
8	The audit	Section 6 of the Act entitles auditors to rights of access at all reasonable times to all documents of the council that the auditor determines are necessary for the audit. The auditor also has a right to require any persons holding or accountable for documents to provide any information and explanations the auditor thinks necessary for the audit. In most instances, however, the audit will be carried out co-operatively, with the council and the auditor agreeing a time when the audit work is to be performed and the RFO will be available to assist the auditor. The Audit Commission provides guidance to external auditors which may be viewed at Appendix 5.

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Step	Task	Comments
9	Publish the accounting statements	Under Regulation 13(4), as soon as reasonably possible after the completion of the audit but no later than September 30, the local council must publish or display its accounting statements and the auditor's certificate. This requirement is met by displaying sections 1 to 3 of the annual return. Copies of the annual return should also be kept for purchase by any person on payment of a reasonable sum. A Public notice in a conspicuous place stating that the audited accounts are available for inspection is required. If the accounts are published before the audit certificate is received, the notice should declare and explain the fact that an audit opinion has not yet been given. DCLG's guidance circular (03/2006) clarifies what is meant by 'publication' in Regulation 13 and gives examples of good practice (see Appendix 7). Although publication does not require any preparation beyond the annual return nor the distribution of copies of the accounting statements to persons who have not expressed an interest in receiving them, it does require positive action. Publication does not mean merely the appearance of the accounts in the documents of meetings, committees or sub-committees of the council. Nor is the requirement covered by merely providing copies to enquirers on demand. Good practice might include putting a copy on each of the council's notice boards, copying it onto a website, publishing it as a separate leaflet or publication in a newspaper or as part of a newsletter. It is a matter for the council to consider the appropriateness of the publication arrangements they have in place, bearing in mind the need to make information as widely available as practicable, but also taking into account local circumstances, including the size of the local council, the resources available, the number of electors, and the existence of any local information networks.

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Step	Task	Comments
10	At the conclusion of the audit, display a notice of public rights	Under Regulation 15, as soon as possible after the auditor has certified that the audit is completed, the council must for at least 14 days display a notice in a conspicuous place that the audit has been completed and that the accounting statements and auditor's opinion (sections 1 to 3 of the annual return) are available for inspection. The accounting statements made available (not the notice itself) must: • contain any amendments required by the auditor's report (or a statement of the amendments that were required); • if auditor's amendments have been made, be accompanied by an explanation as to the material respects in which the accounts have been altered; • contain a statement of the rights of local electors under section 14 of the Audit Commission Act 1998 to inspect and copy the accounting statements and auditor's reports; and • state the address at which and the hours during which the accounting statements and auditor's reports are available for the exercise of these rights.

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Example 1 Cash Book layout

					Receipts			Payments				Vat Transactions		
Date	Details	Voucher No	Receipt	Payment	Hall Booking Fees	Precept	Grants	Clerk's Salary	Administration	Grants	Hall Expenses	VAT Input	VAT Output	VAT Repayment
	Balance brought forward		1,00.75											
20XX														
1 April	Clerk's remuneration	1		100.00				100.00						
2 April	Cleaning materials	2		24.65							20.98	3.67		
8 April	Booking fees	3	75.00		75.00									
21 April	Gas bill	4		102.34							102.34			
22 April	Repair of broken window	5		45.00							38.30	6.70		
27 April	Booking fees	6	100.00		100.00									
30 April	Precept instalment from District Council	7	600.00			600.00								
1 May	Clerk's remuneration	8		100.00				100.00						
7 May	Booking fees	9	75.00		75.00									
15 May	VAT reimbursement	10	10.37											10.37
17 May	Kitchen supplies	11		29.29							24.93	4.36		
17 May	Grant to sports association	12		250.00						250.00				
19 May	Electricity bill	13		96.02							81.72	14.30		
24 May	Booking fees	14	150.00		150.00									
27 May	Office supplies	15		37.69					32.08			5.61		

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					Receipts			Payments				Vat Transactions		
Date	Details	Voucher No	Receipt	Payment	Hall Booking Fees	Precept	Grants	Clerk's Salary	Administration	Grants	Hall Expenses	VAT Input	VAT Output	VAT Repayment
31 May	Grant from Sports Council	17	100.00				100.00							
	Sub-totals for this period		1,110.37	784.99	400.00	600.00	100.00	200.00	32.08	250.00	268.27	34.64	-	34.64
	totals		2,119.12	784.99										
31 May	balance carried forward			1,334.13										
			2,119.12	2,119.12										
1 June	balance brought forward		1,334.13											

The headings used in this example are for illustration only and may not necessarily be those of most use to individual councils.

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Example 2 Schedule of Assets and Investments

Ref No	Description	Identification	Date Acquired	Value	Custodian	Disposal/Discharge
	ASSETS					
001	Offices and grounds	Deeds held at White Horse Bank	11 July 18xx	£300,000 (insurance value)	Caretaker	
002	Ogre Pastorate kitchen oven	Serial No: AURJH231	23 June 20xx	£400	Caretaker	
003	Land Church Drive – for Village Hall Trust	Land Reg cert 48/72/B899	28 December 20xx	N/A	Council as custodian trustee	Held as trustee only
004	Land at Gigg Lane Paddock	Deeds held at White Horse Bank	8 September 19xx	£8,000	Clerk	Sold 9 June 20xx for £10,000
005	HorsePower 324 desktop computer	Serial No: SJND28344	1 March 20xx	£500	Clerk	
006	Blunderbuss CP22 printer	Serial No: LWO19382	1 March 20xx	£100	Clerk	
007	Hall booking fees – Weasley wedding reception	Invoice 00045	8 April 20xx	£150	Clerk	Written off 19 October 20xx – council resolution 146
008	Hall booking fees – Malfoy 18 th birthday	Invoice 00046	10 June 20xx	£150	Clerk	Paid in full 29 June 20xx
009	Investment – (sale of allotment) Treasury Stock 5% 2004	Certificate No XP 45/003 lodged with Bank	19 August 20xx	£40,000	RFO for Investment panel	

Notes

- 3.110 This layout for a schedule of assets would only be suitable for a small council that does not have many fixed assets, or hold stocks. Other councils would need to separate the schedule into different documents:
- an inventory of property;
 - stock control records (for example for bar supplies); and
 - debtors ledgers (for example for allotment rentals).
- 3.111 In determining the layout needed, the objectives to keep in mind are that the schedule should help the council and any person interested:
- to know at any time what its assets and liabilities are and keep them under control; and
 - to prepare the entries in the annual return.

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Example 3 Record of grants

Lottery Funding for Leisure Centre Gym Extension							
Receipts			£	Payments			£
1 May 20xx	Advice	First grant instalment	8,000	30 Apr 20xx	Invoice BL467	First interim payment to Bodgers Ltd	15,432
1 Aug 20xx	Advice	Second grant instalment	8,000	31 Jul 20xx	Invoice BL489	Second interim payment to Bodgers Ltd	17,816
8 Sep 20xx	Advice	Contribution from Philanthropy Ltd	24,000	31 Oct 20xx	Invoice BL504	Final payment to Bodgers Ltd	14,992
1 Nov 20xx	Advice	Third grant instalment	8,000				
		Balance to be paid by the council	240				
		Total	48,240			Total	48,240

Part 4 - Accounting guidance for local councils in England with income or expenditure exceeding £6.5million ('larger local councils')

The Accounts

From financial year 2011/12, local councils where annual turnover exceeds £6.5 million for three consecutive years become larger authorities and must, from the third year onwards, prepare accounts as a larger authority.

The guidance in this section, therefore, applies only to those bodies which are smaller authorities but have exercised the option in Regulation 12(2) of the Accounts and Audit (England) Regulations 2011 to account as if they were a larger authority.

Larger local councils exercising the option should not underestimate the consequential changes to their arrangements that will occur.

JPAG recommends that local councils electing to account as larger authorities should follow the proper accounting practices found in the Financial Reporting Standard for Smaller Entities ('the FRSSE') issued from time to time by the Financial Reporting Council.

Local councils should plan well in advance as they encounter new accounting requirements. These include the need to provide comparative figures in the accounts which means that, effectively, councils should be ready to report their financial statements in accordance with the requirements of the FRSSE for their last year reporting as a smaller authority.

Councils should note in particular that there are certain transitional reliefs that are only available in the first year of accounting under the FRSSE.

Larger local councils may also adopt other recognised accounting standards as proper practices:

- CIPFA Code of Practice on Local Authority Accounting ("the CIPFA SORP") or
- International Financial Reporting Standard for Small and Medium Enterprises (IFRS for SMEs); or
- Any other applicable and relevant standard complying with UK GAAP or, for financial years commencing on or after 1 January 2015, FRS 102.

The Annual Governance Statement

Regulation 4 of the Accounts and Audit Regulations require each council to conduct an annual review of the effectiveness of its system of internal control. Once complete the council must report its findings by including a statement on internal control, prepared in accordance with proper practices, along with its annual financial statements.

Part 2 of this guidance is recognised as proper practice for local councils and requires the production of an annual governance statement. Therefore statements of accounts must include the annual governance statement. The annual governance statement should contain:

- an acknowledgement of council's responsibility for ensuring there is a sound system of internal control;
- an indication of the level of assurance that a system of internal control can provide;
- a brief description of the key elements of the internal control environment;
- a brief description of the process that has been applied in maintaining and reviewing the effectiveness of the system of internal control, including some comment on the role of the council and any committee charged with an overview of the council's governance arrangements, internal audit and any other assurance mechanisms; and
- an outline of the actions taken, or proposed, to deal with significant internal control issues.
- The annual governance statement should be signed by the chair of the council and the chief executive officer or clerk of the council. The minimum amount of disclosure required in the annual governance statement is the same as that contained in the annual return used by smaller local councils (see paragraphs 2.38 to 2.50 above).

Larger local councils that have elected to report as larger authorities may use the annual governance statement in the annual return as a minimum disclosure requirement or apply the guidance contained in the joint CIPFA/SOLACE framework - *Delivering Good Governance in Local Government*.

Appendix 1 – Local council services and powers

Local councils in England operate within a legal framework which provides them with the necessary statutory powers and authority to deliver local public services. There is no one source of the legislation supporting this legal framework and the framework itself is constantly being updated.

Local councils and their clerks must always be aware of and have regard to the legal power they are exercising when deciding on any action including to spend public money. The council clerk is the council's Proper Officer and the primary source of advice to the council as they prepare to make decisions requiring the exercise of their legal powers.

The exercise of legal powers must always be carried out reasonably. For that reason, councils making decisions are expected to and must always understand what power they are exercising in the context of their decision making.

It follows, therefore, that it would be unreasonable for a council to make a decision when it as an entity does not, or councillors individually do not, understand what legal power they are exercising, or whether the power is current, applicable and correct.

To assist councils and their clerks, NALC and SLCC respectively publish information on their websites to guide and assist councils in this respect.

For the purposes of this edition of the Practitioners' Guide, NALC has kindly given permission to publish a link to the 4th Edition of **The Good Councillors Guide** which is available for download from the Booklets and Resources section of their website. You can access the information by following this link:

http://www.nalc.gov.uk/Publications/Booklets_and_Resources.aspx

Section 20 of the Good Councillors Guide, starting at page 57, provides a **List of Legal Powers and Duties**. It is an indicative list of powers and functions to help readers appreciate the wide range of activities covered by Acts of Parliament. It is a useful reference when you need to know if the local council has permission to act. You are reminded to note that no list can be totally comprehensive or current and that if in any doubt it is always advisable to check with an appropriate authority.

Appendix 2 – Statement of responsibilities of auditors and of audited small bodies

General Introduction

1. The Audit Commission (the Commission) is responsible for appointing auditors and determining their terms of appointment, as well as for preparing a Code of Audit Practice (the Code), which prescribes the way auditors are to carry out their functions. The Commission has prepared a Code for the audits of local government bodies and a Code for the audit of local NHS bodies. Schedule 1 to the Local Government Code provides for the audit of small bodies. From time to time, the Commission issues guidance to auditors under section 3(8) of the Audit Commission Act 1998 (the Act) and paragraph 7(3) of Schedule 1 to the Act. This statement sets out guidance on general responsibilities relevant to audits of small bodies and so supports the Code.
2. This statement serves as the formal terms of engagement between the Audit Commission's appointed auditors and small bodies¹. It summarises where the different responsibilities of auditors and of the audited body begin and end, and what is to be expected of the audited body in certain areas. Throughout this statement, the term 'audited body' covers both the members and senior officers of the body.
3. The Code recognises the different needs of small bodies. The Commission has set the threshold for small bodies at £6.5 million to harmonise the accounting and audit requirements for small bodies with those in the Accounts and Audit (England) Regulations 2011. Small bodies have the same responsibilities as principal authorities in relation to governance and accountability although the regulatory approach has been tailored to their needs.
4. The responsibilities of auditors are derived from statute (principally the Audit Commission Act 1998) and from the Code. Nothing in this statement is intended to limit or extend those responsibilities. In particular, audited bodies should note that, because auditors must not prejudice their independence of the audited body, the role of the appointed auditor does not include providing financial or legal advice or consultancy to the audited body.

¹ This statement covers the audits of small audited bodies which Regulation 2 of the Accounts and Audit (England) Regulations 2011 refers to as 'smaller relevant bodies' and defines as those 'whose gross income or gross expenditure (whichever is the higher) is not more than £6.5 million.'

Introduction to responsibilities

5. Those responsible for the conduct of public business and for spending public money are accountable for ensuring that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.
6. In discharging this accountability, public bodies are responsible for putting in place proper arrangements for the governance² of their affairs and the stewardship of the resources at their disposal. They are also required to report on their arrangements in their annual governance statement.
7. It is the responsibility of the audited body to ensure that proper arrangements are in place, but certain individuals may also have specific responsibilities.
8. Small audited bodies will have a chief executive officer, often known as the Clerk, and a Responsible Finance Officer. The Clerk is responsible to the body for the corporate and overall strategic management of the authority and will also advise the body about any actual or potential breaches of the law or any maladministration, and ensure that procedures for recording and reporting key decisions are operating effectively. The Responsible Finance Officer is responsible for the proper administration of the audited bodies' financial affairs.
9. In some small audited bodies, the role of Clerk and Responsible Finance Officer may be combined, although a separation of these two key roles is desirable.
10. In carrying out their work on the annual return, auditors will:
 - plan and manage the audit in a timely, professional and efficient manner;
 - plan to complete work within agreed deadlines;
 - maintain close liaison with the audited body; and
 - provide appropriate and adequate resources and assign responsibilities to staff with the relevant expertise and experience.
11. In meeting their responsibilities, auditors may wish to obtain representations from management, both orally and in writing, on specific aspects of the audit.
12. The following paragraphs summarise the specific responsibilities of auditors and of small audited bodies in relation to the responsibilities of auditors described in the Code.

² The various small bodies covered by this statement are constituted differently and their governance will vary accordingly.

Responsibilities in relation to the accounting statements

13. The accounting statements comprise the annual income and expenditure account, statement of balances or record of receipts and payments that a small body is required to prepare in accordance with, and in the form specified in, any annual return required by proper practices in relation to accounts. They are an essential means by which it accounts for its stewardship of the resources at its disposal and its financial performance in the use of those resources. The annual return is provided by the Audit Commission.
14. It is the responsibility of the small audited body to prepare, publish and provide the auditor with the accounting statements prepared for the financial year, together with such additional information and explanation as is necessary to provide sufficient evidence that it has reviewed and maintained adequate systems of internal control and internal audit throughout the financial year.
15. The audited body is also responsible for preparing, approving and publishing or displaying with its accounting statements an Annual Governance Statement.
16. Auditors examine the annual return, which combines the accounting statements and the annual governance statement and give their opinion in the form of a limited assurance statement.
17. Auditors meet their responsibility by:
 - reviewing compliance with the requirements for the preparation of the accounts;
 - carrying out a high-level analytical review of financial and other information provided to the auditor; and
 - reviewing such additional information and explanation as is necessary to provide sufficient evidence that the audited body has maintained an adequate system of internal control and internal audit throughout the financial year.
18. When the auditor has completed the examination of the annual return and additional information and explanation provided, the auditor gives an opinion on the accounting statements and certifies the completion of the audit.
19. Auditors provide assurance in the form of an opinion whether, on the basis of their review, the accounts and other information provided are in accordance with proper practices and that no matters have come to their attention giving cause for concern that relevant legislation and regulatory requirements have not been met.
20. In carrying out their audit of the accounting statements, auditors have regard to the concept of materiality.
21. Subject to the concept of materiality, auditors provide reasonable assurance that the accounting statements:
 - are free from material misstatement, whether caused by fraud or other irregularity or error; and
 - comply with statutory and other applicable requirements.

22. In carrying out an audit, auditors do not perform detailed tests of all transactions. Therefore the audit process should not be relied upon to disclose all unlawful transactions or events that may have occurred or might occur.
23. Auditors plan and perform their audit on the basis of their assessment of risk. Where necessary, auditors may examine selected transactions and balances on a test basis and assess the significant estimates and judgements made by the audited body in preparing the accounting statements.
24. Auditors may evaluate significant financial systems, and the associated internal financial controls, for the purpose of giving their opinion on the accounting statements. However, they do not provide assurance to small bodies on the operational effectiveness of specific systems and controls or their wider system of internal control. Where auditors identify any weaknesses in such systems and controls, they will draw them to the attention of the audited body, but they cannot be expected to identify all weaknesses that may exist.
25. Auditors review whether the annual governance statement has been presented in accordance with relevant requirements and report if it does not meet these requirements or if it is misleading or inconsistent with other information of which the auditor is aware. In doing so auditors take into account the knowledge of the audited body gained through their work in relation to the accounting statements.
26. Auditors are not required to consider whether the annual governance statement covers all risks and controls, nor are auditors required to form an opinion on the effectiveness of the audited body's corporate governance procedures or risk and control procedures.
27. Where small bodies do not meet agreed timetables and/or provide poor documentation such that additional audit work is necessary, or the audit is delayed, the Commission will charge additional fees to cover the costs incurred.

Specific powers and duties of auditors

28. Auditors have specific powers and duties under the Audit Commission Act 1998 in relation to matters of legality and electors' rights.
29. Auditors must:
- consider whether to issue a public interest report concerning any matter that comes to the auditor's attention during the course of an audit, which they judge should be considered by the audited body or brought to public attention (section 8 of the Act); and
 - give electors the opportunity to raise questions about a small body's accounts, and consider and decide upon objections received from electors in relation to the accounts (sections 15 and 16 of the Act).
30. Auditors may decide:
- that the audited body should consider formally, and respond to in public, recommendations made in an audit report (section 11(3) of the Act);
 - to issue an advisory notice or to apply to the Court for a declaration that an item of account is unlawful (sections 17 and 19A of the Act) if they have reason to believe that unlawful expenditure has been or is about to be incurred by an audited body; and
 - to apply for judicial review with respect to a decision of an audited body or a failure of an audited body to act, which it is reasonable to believe would have an effect on the accounts of that body (section 24 of the Act).
31. Fees arising in connection with auditors' exercise of these powers and duties, including costs relating to the appointment of legal or other advisers to the auditors, are borne by the audited body.

Reporting the results of audit work

32. Auditors provide:
- an audit report including the auditor's opinion on the accounting statements and the annual governance statement; and
 - a certificate that the audit of the accounts has been completed in accordance with statutory requirements.
33. In addition, the following outputs, the need for which may arise at any point during the audit process, are issued where appropriate:
- written reports to officers and, where appropriate, to members on the results of, or matters arising from, specific aspects of auditors' work;
 - a report dealing with any matter that the auditor considers needs to be raised in the public interest under section 8 of the Act; and
 - any recommendations under section 11(3) of the Act.
34. Audit reports are addressed to officers or members of the audited body, as appropriate. Auditors do not have responsibilities to officers or members in their individual capacities (other than observing the rules of natural justice in the exercise

of auditors' specific powers and duties in relation to electors' rights) or to third parties that choose to place reliance upon the reports from auditors.

35. When considering the action to be taken on audit reports, small bodies should bear in mind the scope of the audit and responsibilities of auditors, as set out in the Code and as further explained in this statement. Matters raised by auditors will be drawn from those that come to their attention during the audit. The audit cannot be relied upon to detect all errors, weaknesses or opportunities for improvements in management arrangements that might exist. Small bodies should assess auditors' conclusions and recommendations for their wider implications before deciding whether to accept or implement them.

Ad hoc requests for auditors' views

36. There may be occasions when small bodies will seek the views of auditors on the legality, accounting treatment or value for money of a transaction before embarking upon it. In such cases, auditors are as helpful as possible, but are precluded from giving a definite view in any case because auditors:
- must not prejudice their independence by being involved in the decision-making processes of the audited body;
 - are not financial or legal advisers to the audited body; and
 - may not act in any way that might fetter their ability to exercise the special powers conferred upon them by statute.
37. In response to such requests, auditors can offer only an indication as to whether anything in the information available to them at the time of forming a view could cause them to consider exercising the specific powers conferred upon them by statute. Any response from auditors should not be taken as suggesting that the proposed transaction or course of action will be exempt from challenge in future, whether by auditors or others entitled to raise objection to it. It is the responsibility of the audited body to decide whether to embark on any transaction.

Grant claims and returns

38. Auditors may be required by the Commission to carry out work to support certification of grants or returns. Auditors carry out this work on an agency basis on behalf of the Commission. A separate statement of responsibilities of grant paying bodies, authorities, the Audit Commission and appointed auditors covering this work can be found at www.audit-commission.gov.uk.

Access to information, data security and confidentiality

39. Auditors have wide-ranging rights of access to documents and information in relation to the audit. Such rights apply not only to documents and information held by the audited body and its members and staff, including documents held in electronic form,

but also to the audited body's partners and contractors, whether in the public, private or third sectors. Auditors may also require a person holding or accountable for any relevant document to give them such information and explanation as they consider necessary.

40. There are strict restrictions on the disclosure of information obtained in the course of the audit, subject only to specific exemptions. The Freedom of Information Act 2000 does not apply to the Commission's appointed auditors, as they have not been designated as 'public authorities' for the purposes of that legislation, although they are subject to the Environmental Information Regulations 2004. Small bodies wishing to disclose information obtained from an auditor, which is subject to a statutory restriction on its disclosure, must seek the auditor's consent to that disclosure.
41. Auditors protect the integrity of data relating to small bodies and individuals either received or obtained during the audit. They ensure that data are held securely and that all reasonable steps are taken to ensure compliance with statutory and other requirements relating to the collection, holding and disclosure of information.

<http://www.audit-commission.gov.uk/audit-regime/codes-of-audit-practice/statement-of-responsibilities-of-auditors-and-audited-bodies/>

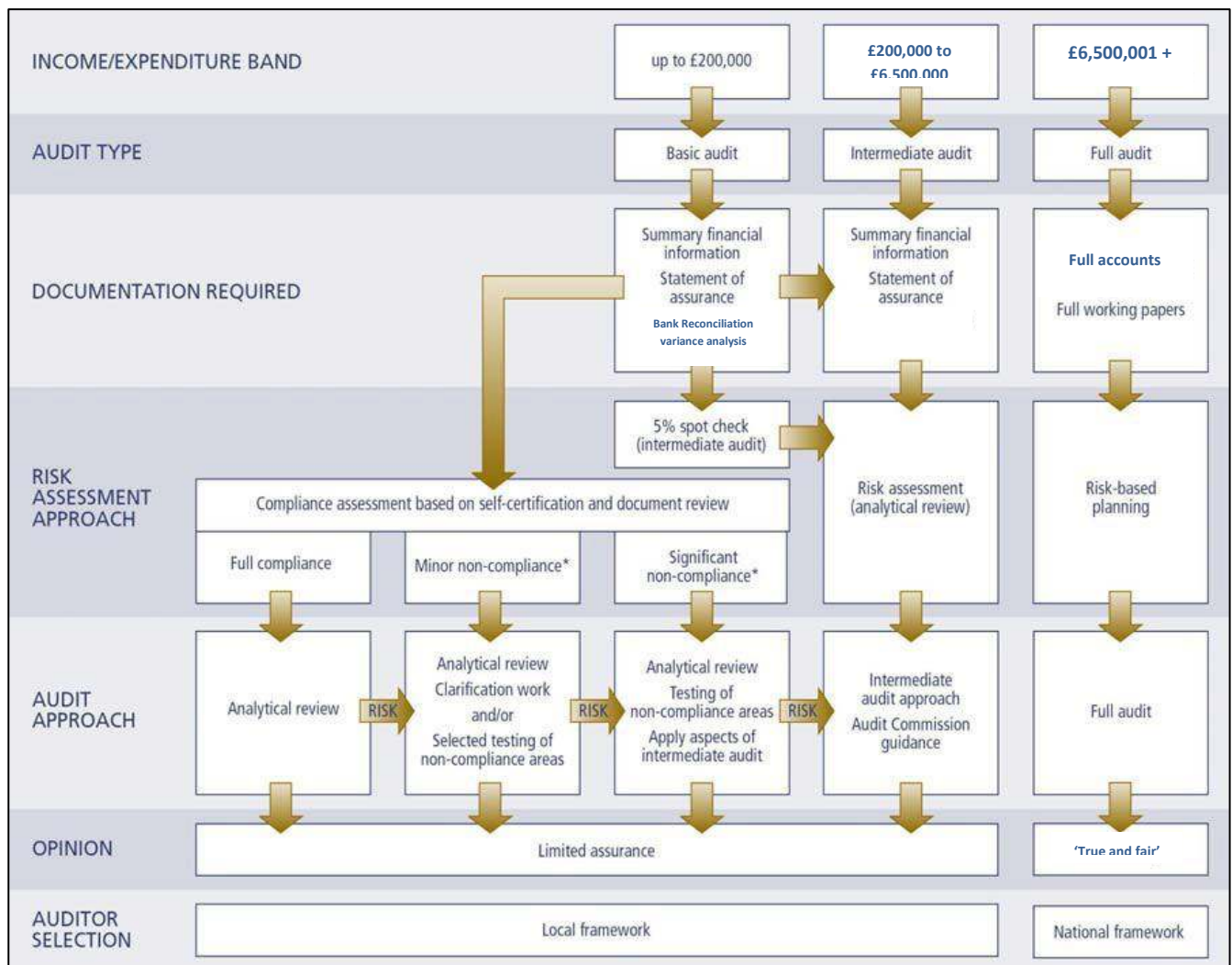
Appendix 3 – The approach to the audit of local councils in England

1 The limited assurance audit approach distinguishes between three types of local council:

- councils with annual income or expenditure of £6.5 million or more;
- councils with neither annual income or expenditure in excess of £6.5 million; and
- councils with neither annual income nor expenditure exceeding £200,000.

2 The exhibit below describes the new audit approach to each of the three groups.

Figure 1 Exhibit Local council audit – model of delivery



*Non-compliance indicates the presence of unmitigated risk factors which will lead to a more intensive audit as required

Appendix 4 – Extract from the Audit Commission's Code of Audit Practice 2010

Schedule 1: The audit of small bodies

Introduction

S1.1 This Schedule sets out the approach to be adopted for the audit of those bodies (referred to in this Schedule as small bodies) with either annual income or annual expenditure below a financial threshold, which may change from time to time and is prescribed by relevant regulations.¹

Governance and accountability

S1.2 It is the responsibility of small bodies to put in place proper arrangements to ensure the proper conduct of their financial affairs, and to monitor the adequacy and effectiveness of those arrangements in practice. Small bodies are required to maintain proper accounting records and control systems and to maintain an adequate system of internal audit of those accounting records and control systems.

S1.3 Small bodies are responsible for preparing and publishing, and providing the auditor with, the accounting statements prepared for the financial year, together with such additional information and explanation as is necessary to provide sufficient evidence that they have maintained adequate systems of internal control and internal audit throughout the financial year.

The audit approach

S1.4 Auditors of small bodies should undertake an examination of the accounts and additional information and explanation provided by the body.

S1.5 Auditors should meet their responsibility by:

- reviewing compliance with the requirements for the preparation of the accounts;
- carrying out a high-level analytical review of financial and other information provided to the auditor; and
- reviewing such additional information and explanation as is necessary to provide sufficient evidence that the body has maintained an adequate system of internal control and internal audit throughout the financial year.

¹ Regulations made under section 27 of the Act prescribe a financial threshold for the purposes of determining the type of financial statements that a body is required to prepare and for other purposes.

S1.6 Where, on the basis of the auditor's reviews, the auditor requires further evidence in relation to any relevant matter, additional testing should be undertaken to address the auditor's concerns.

S1.7 When the auditor has completed an examination of the accounts and additional information and explanation provided, the auditor gives an opinion on the accounting statements and certifies the completion of the audit. Auditors provide assurance in the form of an opinion whether, on the basis of their review, the accounts and the other information provided are in accordance with the specified requirements and that no matters have come to their attention giving cause for concern that relevant legislative and regulatory requirements have not been met.

Appendix 5 – Standing Guidance issued by the Audit Commission to External Auditors to small bodies on the overall scope and approach of their audit

Appendix 17: Audit approach for small bodies

- 1 **Schedule 1 of the Code of Audit Practice describes the Commission’s audit approach for small bodies.** This requires limited procedures to give a limited assurance opinion and the approach is therefore fundamentally different to that for principal local authorities.
- 2 Auditors’ work focuses on:
 - a compliance check against the requirements of the annual return;
 - high level analytical review of financial and other information requested by the auditor; and
 - review of the small body’s annual governance statement.

Scope of work required

- 3 The approach is detailed in Appendix 3 of the Practitioners’ Guide and depends on the financial activity of the small body:

Financial activity	The small body ...	The auditor ...
No financial activity in the year of account	Completes a declaration of no accounts	On receipt of the declaration, takes no further action
Both gross annual expenditure and income £200,000 or less	Completes an annual return including accounting statements and an annual governance	Undertakes a ‘basic audit’ unless selected as part of the 5 per cent sample of such

Financial activity	The small body ...	The auditor ...
	statement Gives notice of the audit, including the availability of accounts and supporting documents for inspection Allows interested persons to inspect the accounts and supporting documents	bodies to which 'intermediate audit' procedures are applied Enters a certificate and opinion on the annual return
Either gross annual income or expenditure or both exceed £200,000	Completes an annual return including accounting statements and an annual governance statement Gives notice of the audit, including the availability of accounts and supporting documents for inspection Allows interested persons to inspect the accounts and supporting documents	Undertakes an 'intermediate audit' Enters a certificate and opinion on the annual return

- 4 **Auditors must exercise professional judgement on how best to carry out the work required in reaching a limited assurance opinion on annual returns within the framework established by the Audit Commission.**

Calling of audits

- 5 All audits must be 'called' by the auditor. This process is a legal requirement designed to ensure that the statutory rights of electors can be exercised.
- 6 **Auditors must appoint a date on or after which electors' rights may be exercised, and notify the small body.** Auditors should make their own administrative arrangements for calling audits, but may wish to use the Commission's form AF3 which is designed for this purpose

and issued to auditors annually.

Responsibilities of small bodies

- 7 Small bodies complete and return an approved annual return sent to them by the auditor when calling the audit. The Responsible Finance Officer (RFO) certifies the accounting statements present fairly the financial position of the council and its income and expenditure, or properly present receipts and payments, as the case may be. The RFO then arranges for three sections of the annual return to be completed and signed off:
- **Section 1: Accounting statements** – prepared in accordance with the Practitioners' Guide and approved by the body (a function that cannot be delegated);
 - **Section 2: Annual governance statement (AGS)** – comprising 'yes', 'no' or 'not applicable answers' to nine questions (for local councils) eight questions (for other bodies) and approved by the body;
 - **Section 4: Annual report by the internal auditor** – providing an independent report on the adequacy and effectiveness of the body's system of internal control.

Basic audit

- 8 The auditor obtains from the body with the annual return the following key information:
- year-end bank reconciliation. There is no prescribed format but an example is provided in the Practitioners' Guides. Small bodies may attach annotated copies of bank statement pages covering the 31 March financial year end to the reconciliation, but annotated bank statements are not acceptable as an alternative to providing a bank reconciliation; and
 - explanation(s) of significant variances in the accounting statements.
- 9 Auditors will have arrangements in place with billing authorities in each of their contract areas to receive local council precept data for the relevant financial year.
- 10 Auditors may also:
- obtain information about balances of borrowings by small bodies from the Public Works Loan Board ('PWLB'); and
 - request an independent verification of bank and investment balances if the audit process or unresolved omission or error on the annual return, or some other justifiable reason, indicates possible irregularity with regard to cash. Auditors should inform the body when taking this action, recognising that there will be a cost: banks may charge for this service.

Intermediate audit

- 11 The intermediate audit involves:
 - basic audit procedures; and
 - additional procedures to reflect the risks associated with higher levels of activity.
- 12 Auditors identify one or more of the assertions in the annual governance statement in part 2 of the annual return to test how well the body understands its responsibilities and duties, using the testing detailed in Annex 1 to this Appendix.
- 13 Therefore, in deciding how to apply the testing schedule below, the auditor should take into account their:
 - initial risk assessment; and
 - cumulative audit knowledge and experience
- 14 To determine the extent and frequency of testing, the auditor should also consider:
 - the outcome of analytical review; and
 - the level of compliance with requirements, including previous internal and external audit reporting.
- 15 Evidence requested by auditors for intermediate audit should be proportionate to audit risk. Auditors should minimise additional information requests by planning a cyclical approach to the audit of the annual governance statement based on risk.
- 16 In order to reduce the frequency of correspondence and to provide a reasonable time for response, the Commission recommends that auditors highlight additional evidence being sought for intermediate audit when calling the audit. Provision for this is made in form AF3.
- 17 The cost of intermediate audit, whether determined by the turnover of the small body or required for the 5 per cent sample, is included in the scale fees.

Additional enquiries or work

- 18 Auditors should:
 - in cases where a fully compliant annual return is submitted and analytical review indicates no unresolved material audit risk, complete the audit by signing the report in section 3 of the return;
 - in instances where further evidence or information is required from the small body, give the body reasonable opportunity to comply before undertaking additional work; or
 - if the examination of the annual return indicates that additional audit work is required before an opinion can be reached, identify the

specific area of concern and the additional work required, targeted at the specific area of concern.

- 19 **If additional work is required, auditors must before undertaking the work:**
- **estimate the time cost;**
 - **document their rationale on the audit file;**
 - **inform the audited body before commencing the work; and**
 - **update the audited body on the progress and cumulative cost if the work takes place over an extended period.**

Reporting the results of the audit

- 20 Auditors must always exercise their professional judgment in deciding whether additional reporting is necessary and, if so, whether to qualify an annual return and when to report on other matters not affecting the audit opinion
- 21 Auditors should have regard to the guidance in Annex 2 on reporting against potential findings for annual governance statement assertions 1, 4, 5 and 7.
- 22 Auditors should consider the following principles when deciding to report on other matters:
- auditors should not use 'other matter' reporting where an issue is sufficiently important to merit a qualification;
 - auditors should use 'other matters' reporting principally for 'at risk' accounting and governance issues for the body arising from audit to alert those charged with governance and local electors (see Appendix 17, Annex 2, page 96);
 - other matters reporting may also be used draw attention to a small body's failure to provide requested information with the AR or complete the AR correctly;
 - in cases where the auditor has undertaken additional work to give an opinion on the AR, other matters reporting space may be used to explain the reasons for this and the additional fee charged;
 - all reporting by auditors should be in section 3 of the AR. If space limitations prevent complete reporting then continuation sheets may be used. If continuation sheets are used, they must be clearly marked as being part of the audited AR and subject to display and inspection in accordance with the requirements of the Accounts and Audit Regulations; and

- it is not appropriate for auditors to draw audited bodies' attention to any matters within letters whose primary purpose is to cover the return of audited annual returns and fee notes, unless the matters are reported in section 3 of the annual return.

Support for audited bodies

- 23 In support of the limited assurance audit approach, the Commission works closely with local councils through their representative bodies, the National Association of Local Councils (NALC) and the Society of Local Council Clerks (SLCC). Similarly, in relation to Internal Drainage Boards, the Commission works with the Association of Drainage Authorities (ADA).
- 24 The Commission supports NALC's, SLCC's and ADA's technical advisory networks. **Auditors should refer audited bodies to these networks for technical accounting queries or audit framework questions.**

Annex 1 to Appendix 17

Intermediate audits – potential further tests and documentation

Annual governance statement assertion	Audit objectives	Possible additional documentation request
“we have approved the accounting statements prepared in accordance with the requirements of the Accounts and Audit Regulations and proper practices”	Confirm the body understands ‘proper practices’ Confirm arrangements for producing accounting statements in accordance with regulations and proper practices Confirm arrangements for reviewing bank reconciliation	Written assurance that members have access to a copy of the Practitioners’ Guide Copy of accounting records on which annual return is based. Copy of extended trial balance (if I&E) Copy of closing bank statements
“we have maintained an adequate system of internal control, including measures designed to prevent and detect fraud and corruption and reviewed its effectiveness”	Confirm that system of internal control is fully documented Confirm arrangements to report on internal controls and arrangements to prevent and detect fraud and corruption	Copy of internal auditor’s reports Copy of minute(s) where internal controls discussed/approved Copy of annual review of internal control or minute relating to its consideration
“we have taken all reasonable steps to assure ourselves that there are no matters of actual or potential non-compliance with laws, regulations and codes of practice which could have a significant financial effect on the ability of the small body to conduct its business or on its finances”	Confirm that all expenditure and income decisions made are within existing powers and minuted Confirm that the small body has adopted Standing Orders and Financial Regulations Confirm that the small body has adopted, provides training on and applies applicable Codes of Conduct	Copies of minutes for a selected period showing expenditure and income powers have been properly identified Copy of Standing Orders/Financial Regulations and/or minute adopting or periodically reviewing Copies of members’ acceptance of office

Annual governance statement assertion	Audit objectives	Possible additional documentation request
		Evidence of training on Codes of Conduct
“we have provided proper opportunity during the year for the exercise of electors’ rights in accordance with the requirements of the Accounts and Audit Regulations”	Confirm that the notice of audit has been prominently advertised/displayed Confirm that the notice of completion of the audit has been properly advertised/displayed Confirm that accounts have been made available to electors	Copy of notice of audit Copy of notice of completion of audit Details of arrangements in place for inspection of accounts
“we have carried out an assessment of the risks facing the small body and taken appropriate steps to manage those risks, including the introduction of internal controls and/or external insurance cover where required”	Confirm arrangements for risk management and how this has been carried out/updated and/or considered by the small body Confirm that appropriate insurance cover for identified risks is in place Confirm small body regularly seeks assurance regarding internal controls	Copy of minutes of meetings considering risk management and insurance coverage Copy of any risk assessment documentation or reports (if any)
“we have maintained throughout the year an adequate and effective system of internal audit of the accounting records and control systems”	Confirm that internal audit does not undertake tasks or give advice which may compromise or fetter their independence or invalidate the small body’s insurance	Copy of minute appointing/reappointing internal audit Copy of letter of engagement scoping internal audit Minutes of annual review of internal audit

Annual governance statement assertion	Audit objectives	Possible additional documentation request
“we have taken appropriate action on all matters raised in previous reports from internal and external audit”	Confirm that all internal and external audit reports have been considered by the body Confirm that there are no outstanding matters from previous audit reports	Copy of minutes recording consideration of auditors’ report Copy of agreed action plans to implement recommendations.
“we have considered whether any litigation, liabilities or commitments, events or transactions, occurring either during or after the year-end, have a financial impact on the body and where appropriate have included them in the accounting statements”	Confirm that body has budgeted for adequate but not excessive reserves Confirm that where there are any claims against the small body, any uninsured portion has been taken into account in budget setting Confirm the small body borrows money only for financing capital schemes and obtains borrowing approval	Copy of reports and minutes supporting budget setting Details of any claims outstanding against the body Details of any loans Details of any current or planned lottery bids Details of capital programme
For local councils only (where applicable) “Trust funds (including charitable) – in our capacity as sole managing trustee, we have discharged our responsibility in relation to the accountability for the fund(s)/assets, including financial reporting and if required, independent examination or audit”	Where line 11 of the accounting statements discloses a council is a sole trustee: ○ Confirm trust accounts prepared in accordance with trust deed and reported to Charity Commission requirements ○ Confirm banking arrangements for council and trust allow adequate separation ○ Confirm date of annual filing of trust accounts ○ Confirm that council distinguishes clearly when acting in capacity as a trustee	Annual report to Charity Commission. Copy of charity accounts and auditor’s or examiner’s report (where relevant) Copy of bank statement for trust fund Minutes of meetings at which council acts in capacity of trustee.

Annex 2 to Appendix 17

Consideration of qualification of auditor's report as a result of matters relating to the Annual Governance Statement (AGS)

AGS Assertion	Auditor finding (after any follow-up work as appropriate)	Qualify opinion re section 1 of the Annual Return?	Qualify opinion re section 2 of the Annual Return?	Report as 'other matters not affecting our opinion'?	Comments
1	The accounting statements in section 1 of the Annual Return have not been prepared in accordance with proper practices.	Yes	Yes	No	A failure to produce accounting statements in the form required by proper practices represents a fundamental compliance failure.
1	The date in section 1 shows that the Annual Return was not approved by 30 June.	No	Yes	No	Assertion 1 is intended to relate to both the approval and preparation of the statement of accounts. However there is currently some ambiguity in the way the assertion is worded. The Commission will request JPAG to review and revise the wording for the 2013/14 Annual Return.
1	The Responsible Financial Officer did not sign section 1 of the Annual Return.	Yes	Yes	No	The certificate in section 1 is incomplete without the RFO's signature which is a fundamental compliance failure.
1	The Chair of the council (or equivalent) did not sign section 1 of the Annual Return, but the auditor has received other evidence that the accounts were approved by the body.	No	No	Yes	The signature of the chair (or equivalent) on section 1 of the Annual Return can be accepted as confirmation that the accounting statements were approved by the body. The primary evidence, however, is the relevant minute of the meeting at which section 1 of the Annual Return was approved and not the presence of a signature of the chair of

AGS Assertion	Auditor finding (after any follow-up work as appropriate)	Qualify opinion re section 1 of the Annual Return?	Qualify opinion re section 2 of the Annual Return?	Report as 'other matters not affecting our opinion'?	Comments
					the meeting.
1	The Chair of the council (or equivalent) did not sign section 1 of the Annual Return, and no other evidence of approval was provided.	No	Yes	No	Fails the 'show me' test on the AGS assertion.
4	The body is unable to provide a copy of the notice of audit (AF3 or equivalent).	No	Yes	No	Fails the 'show me' test on the AGS assertion.
4	The body provides a notice of audit which shows that the inspection period was shorter than that required by the Accounts and Audit Regulations.	No	No	Yes	If the inspection period is inadequate, auditors may suspend the audit and request re-performance. Decisions about the level of reporting are informed by the auditor's judgement of significance and impact of the non-compliance.
5	The body is unable to provide documentary evidence showing how risk management has been considered by those charged with governance during the year.	No	Yes	No	Fails the 'show me' test on the AGS assertion.
5	The body provides minutes of a risk management discussion which identified risks but does not provide evidence of any	No	Yes	No	Fails the 'show me' test on the AGS assertion.

AGS Assertion	Auditor finding (after any follow-up work as appropriate)	Qualify opinion re section 1 of the Annual Return?	Qualify opinion re section 2 of the Annual Return?	Report as 'other matters not affecting our opinion'?	Comments
	action to manage them.				
5	The body provides an insurance schedule alongside evidence of having carried out a risk assessment. The auditor accepts that the risk assessment was adequate, but notes that the value of the body's Fidelity Guarantee bond may not be sufficient.	No	No	Yes	Auditors should however restrict the use of 'other matters' reporting to key 'at risk' issues for the body in order to alert both those charged with governance and local electors.
7	The auditor follows up an 'other matter not affecting our opinion' from the prior year audit. The body is unable to provide documentary evidence that the matter has been addressed in the current year.	No	Yes	No	Fails the 'show me' test on the AGS assertion. Auditors may consider qualifying assertion 7 <i>and</i> the assertion relating to the prior year's 'other matter'.

Appendix 6 – Annual return for local councils for the year ending 31 March 2014

Local Councils in England

Annual return for the financial year ended 31 March 2014

Local councils in England with an annual turnover of £6.5 million or less must complete an annual return in accordance with proper practices summarising their activities at the end of each financial year. In this annual return the term 'local council' includes a Parish Meeting, a Parish Council and a Town Council.

The annual return on pages 2 to 5 is made up of four sections:

- Sections 1 and 2 are completed by the person nominated by the local council.
- Section 3 is completed by the external auditor appointed by the Audit Commission.
- Section 4 is completed by the local council's internal audit provider.

Each council must approve this annual return no later than 30 June 2014.

Completing your annual return

Guidance notes, including a completion checklist, are provided on page 6 and at relevant points in the annual return.

Complete all sections highlighted in green. Do not leave any green box blank. Incomplete or incorrect returns require additional external audit work and may incur additional costs.

Send the annual return, together with your bank reconciliation as at 31 March 2014, an explanation of any significant year on year variances in the accounting statements and any additional information requested, to your external auditor by the due date.

Your external auditor will identify and ask for any additional documents needed for audit. Therefore, unless requested, do not send any original financial records to the external auditor.

Audited and certified annual returns will be returned to the local council for publication or public display of sections 1, 2 and 3. You must publish or display the audited annual return by 30 September 2014.

It should not be necessary for you to contact the external auditor or the Audit Commission directly for guidance.

More guidance on completing this annual return is available in the Practitioners' Guide for local councils that can be downloaded from www.nalc.gov.uk or from www.slcc.co.uk

Section 1 – Accounting statements 2013/14 for

Enter name of
reporting body here:

Council/Meeting

Readers should note that throughout this annual return references to a 'local council' or 'council' also relate to a parish meeting.

	Year ending				Notes and guidance
	31 March 2013 £		31 March 2014 £		Please round all figures to nearest £1. Do not leave any boxes blank and report £0 or Nil balances. All figures must agree to underlying financial records.
1	Balances brought forward				Total balances and reserves at the beginning of the year as recorded in the financial records. Value must agree to Box 7 of previous year.
2	(+ Annual precept				Total amount of precept received or receivable in the year.
3	(+ Total other receipts				Total income or receipts as recorded in the cashbook less the precept received (line 2). Include any grants received here.
4	(-) Staff costs				Total expenditure or payments made to and on behalf of all employees. Include salaries and wages, PAYE and NI (employees and employers), pension contributions and employment expenses.
5	(-) Loan interest/capital repayments				Total expenditure or payments of capital and interest made during the year on the council's borrowings (if any).
6	(-) All other payments				Total expenditure or payments as recorded in the cashbook less staff costs (line 4) and loan interest/capital repayments (line 5).
7	(=) Balances carried forward				Total balances and reserves at the end of the year. Must equal (1+2+3) – (4+5+6)
8	Total cash and short term investments				The sum of all current and deposit bank accounts, cash holdings and short term investments held as at 31 March – to agree with bank reconciliation.
9	Total fixed assets plus other long term investments and assets				The original Asset and Investment Register value of all fixed assets, plus other long term assets owned by the council as at 31 March
10	Total borrowings				The outstanding capital balance as at 31 March of all loans from third parties (including PWLB).
11	Disclosure note				The council acts as sole trustee for and is responsible for managing trust funds or assets. The figures in the accounting statements above do not include any trust transactions.
	Trust funds (including charitable)	yes	no	yes	

I certify that for the year ended 31 March 2014 the accounting statements in this annual return present fairly the financial position of the council and its income and expenditure, or properly present receipts and payments, as the case may be.

Signed by Responsible Financial Officer

SIGNATURE REQUIRED

Date

DD/MM/YYYY

I confirm that these accounting statements were approved by the council on this date:

DD/MM/YYYY

and recorded as minute reference:

MINUTE REFERENCE

Signed by Chair of the meeting approving these accounting statements.

SIGNATURE REQUIRED

Date

DD/MM/YYYY

Section 2 – Annual governance statement 2013/14

We acknowledge as the members of:

Council/Meeting

our responsibility for ensuring that there is a sound system of internal control, including the preparation of the accounting statements. We confirm, to the best of our knowledge and belief, with respect to the accounting statements for the year ended 31 March 2014, that:

	Agreed –		'Yes' means that the council:
	Yes	No*	
1 We approved the accounting statements prepared in accordance with the requirements of the Accounts and Audit Regulations and proper practices.			prepared its accounting statements in the way prescribed by law.
2 We maintained an adequate system of internal control, including measures designed to prevent and detect fraud and corruption and reviewed its effectiveness.			made proper arrangements and accepted responsibility for safeguarding the public money and resources in its charge.
3 We took all reasonable steps to assure ourselves that there are no matters of actual or potential non-compliance with laws, regulations and proper practices that could have a significant financial effect on the ability of the council to conduct its business or on its finances.			has only done what it has the legal power to do and has complied with proper practices in doing so.
4 We provided proper opportunity during the year for the exercise of electors' rights in accordance with the requirements of the Accounts and Audit Regulations.			during the year has given all persons interested the opportunity to inspect and ask questions about the council's accounts.
5 We carried out an assessment of the risks facing the council and took appropriate steps to manage those risks, including the introduction of internal controls and/or external insurance cover where required.			considered the financial and other risks it faces and has dealt with them properly.
6 We maintained throughout the year an adequate and effective system of internal audit of the council accounting records and control systems.			arranged for a competent person, independent of the financial controls and procedures, to give an objective view on whether internal controls meet the needs of the council.
7 We took appropriate action on all matters raised in reports from internal and external audit.			responded to matters brought to its attention by internal and external audit.
8 We considered whether any litigation, liabilities or commitments, events or transactions, occurring either during or after the year-end, have a financial impact on the council and, where appropriate have included them in the accounting statements.			disclosed everything it should have about its business activity during the year including events taking place after the year-end if relevant.
9 Trust funds (including charitable) – in our capacity as the sole managing trustee we discharged our responsibility in relation to the accountability for the fund(s)/assets, including financial reporting and, if required, independent examination or audit.	yes	no	NA
			has met all of its responsibilities where it is a sole managing trustee of a local trust or trusts.

This annual governance statement is approved by the council and recorded as minute reference

MINUTE REFERENCE

dated DD/MM/YYYY

Signed by:

Chair SIGNATURE REQUIRED

dated DD/MM/YYYY

Signed by:

Clerk SIGNATURE REQUIRED

dated DD/MM/YYYY

*Note: Please provide explanations to the external auditor on a separate sheet for each 'No' response. Describe how the council will address the weaknesses identified.

Section 3 – External auditor certificate and opinion 2013/14

Certificate

We certify that we have completed the audit of the annual return for the year ended 31 March 2014 of

Council/Meeting

Respective responsibilities of the council and the auditor

The council is responsible for ensuring that its financial management is adequate and effective and that it has a sound system of internal control. The council prepares an annual return in accordance with proper practices which:

- summarises the accounting records for the year ended 31 March 2014; and
- confirms and provides assurance on those matters that are important to our audit responsibilities.

Our responsibility is to conduct an audit in accordance with guidance issued by the Audit Commission and, on the basis of our review of the annual return and supporting information, to report whether any matters that come to our attention give cause for concern that relevant legislation and regulatory requirements have not been met.

External auditor report

(Except for the matters reported below)* on the basis of our review, in our opinion the information in the annual return is in accordance with proper practices and no matters have come to our attention giving cause for concern that relevant legislation and regulatory requirements have not been met.
(*delete as appropriate).

(continue on a separate sheet if required)

Other matters not affecting our opinion which we draw to the attention of the council:

(continue on a separate sheet if required)

External auditor signature

External auditor name Date

Note: The auditor signing this page has been appointed by the Audit Commission and is reporting to you that they have carried out and completed all the work that is required of them by law. For further information please refer to the Audit Commission's publication entitled Statement of Responsibilities of Auditors and of Audited Small Bodies.

Section 4 – Annual internal audit report 2013/14 to

Council/Meeting

The council's internal audit, acting independently and on the basis of an assessment of risk, carried out a selective assessment of compliance with relevant procedures and controls expected to be in operation during the financial year ended 31 March 2014.

Internal audit has been carried out in accordance with the council's needs and planned coverage. On the basis of the findings in the areas examined, the internal audit conclusions are summarised in this table. Set out below are the objectives of internal control and alongside are the internal audit conclusions on whether, in all significant respects, the control objectives were being achieved throughout the financial year to a standard adequate to meet the needs of the council.

Internal control objective	Agreed? Please choose only one of the following		
	Yes	No*	Not covered**
A Appropriate books of account have been kept properly throughout the year.			
B The council's financial regulations have been met, payments were supported by invoices, all expenditure was approved and VAT was appropriately accounted for.			
C The council assessed the significant risks to achieving its objectives and reviewed the adequacy of arrangements to manage these.			
D The annual precept requirement resulted from an adequate budgetary process; progress against the budget was regularly monitored; and reserves were appropriate.			
E Expected income was fully received, based on correct prices, properly recorded and promptly banked; and VAT was appropriately accounted for.			
F Petty cash payments were properly supported by receipts, all petty cash expenditure was approved and VAT appropriately accounted for.			
G Salaries to employees and allowances to members were paid in accordance with council approvals, and PAYE and NI requirements were properly applied.			
H Asset and investments registers were complete and accurate and properly maintained.			
I Periodic and year-end bank account reconciliations were properly carried out.			
J Accounting statements prepared during the year were prepared on the correct accounting basis (receipts and payments or income and expenditure), agreed to the cash book, were supported by an adequate audit trail from underlying records, and where appropriate debtors and creditors were properly recorded.			
K Trust funds (including charitable) The council met its responsibilities as a trustee.	Yes	No	Not applicable

For any other risk areas identified by the council (list any other risk areas below or on separate sheets if needed) adequate controls existed:

Name of person who carried out the internal audit

Signature of person who carried out the internal audit Date

*Note: If the response is 'no' please state the implications and action being taken to address any weakness in control identified (add separate sheets if needed).

**Note: If the response is 'not covered' please state when the most recent internal audit work was done in this area and when it is next planned, or, if coverage is not required, internal audit must explain why not (add separate sheets if needed).

Guidance notes on completing the 2013/14 annual return

- 1 You must apply proper practices for preparing this annual return. Proper practices are found in the Practitioners' Guide* which is updated from time to time and contains everything you should need to prepare successfully for your financial year-end and the subsequent audit. Both NALC and SLCC have helplines if you want to talk through any problem you encounter.
- 2 Make sure that your annual return is complete (i.e. no empty green boxes), and is properly signed and dated. Avoid making any amendments to the completed return. But, if this is unavoidable, make sure the amendments are drawn to the attention of and approved by the council, properly initialled and an explanation is provided to the external auditor. Annual returns containing unapproved or unexplained amendments will be returned unaudited and may incur additional costs.
- 3 Use the checklist provided below. Use a second pair of eyes, perhaps a council member or the Chair, to review your annual return for completeness before sending it to the external auditor.
- 4 Do not send the external auditor any information not specifically asked for. Doing so is not helpful. However, you must notify the external auditor of any change of Clerk, Responsible Finance Officer or Chair.
- 5 Make sure that the copy of the bank reconciliation which you send to your external auditor with the annual return covers all your bank accounts. If your council holds any short-term investments, note their value on the bank reconciliation. The external auditor must be able to agree your bank reconciliation to Box 8 on the Accounting Statements (Section 1). You must provide an explanation for any difference between Box 7 and Box 8. More help on bank reconciliation is available in the Practitioners' Guide*.
- 6 Explain fully significant variances in the accounting statements on page 2. Do not just send in a copy of your detailed accounting records instead of this explanation. The external auditor wants to know that you understand the reasons for all variances. Include complete analysis to support your explanation. There are a number of examples provided in the Practitioners' Guide* to assist you.
- 7 If the external auditor has to review unsolicited information, or receives an incomplete bank reconciliation, or you do not fully explain variances, this may incur additional costs for which the auditor will make a charge.
- 8 Make sure that your accounting statements add up and the balance carried forward from the previous year (Box 7 of 2013) equals the balance brought forward in the current year (Box 1 of 2014).
- 9 Do not complete section 3. The external auditor will complete it at the conclusion of the audit.

Completion checklist – 'No' answers mean you may not have met requirements		Done?
All sections	All green boxes have been completed?	
	All information requested by the external auditor has been sent with this annual return? Please refer to your notice of audit.	
Section 1	Council approval confirmed by signature of Chair of meeting approving accounting statements?	
	An explanation of significant variations from last year to this year is provided?	
	Bank reconciliation as at 31 March 2014 agreed to Box 8?	
	An explanation of any difference between Box 7 and Box 8 is provided?	
Sections 1 and 2	Trust funds – all disclosures made if council is a sole managing trustee? NB: Do not send trust accounting statements unless requested.	
Section 2	For any statement to which the response is 'no', an explanation is provided?	
Section 4	All green boxes completed by internal audit and explanations provided?	

*Note: Governance and Accountability for Local Councils in England – A Practitioners' Guide is available from your local NALC and SLCC representatives or from www.nalc.gov.uk or www.slcc.co.uk

Appendix 7 – Accounts and Audit Regulations and Guidance

Accounts and Audit (England) Regulations 2011 – SI 2011 No 817

<http://www.legislation.gov.uk/ukxi/2011/817/part/4/made>

CLG Guidance Circular 03/2006

<https://www.gov.uk/government/publications/accounts-and-audit-regulations-2003-circular-03-2006>

Appendix 8 – Local Government Investments – DCLG Guidance

The Department of Communities and Local Government (DCLG) Guidance on Local government Investments (second edition) issued 11 March 2010

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/11298/1501971.pdf

Practitioners are directed to paragraphs that specifically refer to parishes – paragraph 5 in Part 1 and paragraph 3.3 in Part 2 - which clarify the extent to which they are expected to apply the guidance.

Appendix 9 – An approach to internal audit testing

- 1 The council will determine the scope and coverage of the work to be carried out by internal audit in accordance with proper practices guidance. Internal audit testing of internal controls will be sufficient for the proper completion of the annual internal audit report. The annual internal audit report should provide an adequate level of assurance for the council to complete assertions 2 and 6 in its annual governance statement.
- 2 In completing the annual report at section 4 of the annual return, internal audit will have planned and carried out the work necessary to give the assurances called for. The ten key control tests in the annual report represent the minimum level of internal audit coverage required. Additional testing and reporting should be tailored to local circumstances.
- 3 Internal audit work always requires the application of judgement and should only be carried out following risk assessment. The scope and frequency of testing should reflect that assessment, and therefore should always be in proportion to the likelihood of fraud, error or misstatement that could occur. It should be directly related to the size and level of business activity of the council.
- 4 The following schedule suggests an approach to the testing of key internal controls to provide assurance that the minimum level of coverage has been met.

Internal Control	Suggested testing
Proper bookkeeping	• Is the cashbook maintained and up to date? • Is the cashbook arithmetic correct? • Is the cashbook regularly balanced?
a) standing orders and financial regulations adopted and applied; and b) payments controls	• Has the council formally adopted standing orders and financial regulations? • Has a Responsible finance officer been appointed with specific duties? • Have items or services above the de minimus amount been competitively purchased? • Are payments in the cashbook supported by invoices, authorised and minuted? • Has VAT on payments been identified, recorded and reclaimed? • Is s137 expenditure separately recorded and within statutory limits?
Risk management arrangements	• Does a review of the minutes identify any unusual financial activity? • Do minutes record the council carrying out an annual risk assessment? • Is insurance cover appropriate and adequate? • Are internal financial controls documented and regularly reviewed?

Continued

Internal Control	Suggested testing
Budgetary Controls	• Has the council prepared an annual budget in support of its precept? • Is actual expenditure against the budget regularly reported to the council? • Are there any significant unexplained variances from budget?
Income Controls	• Is income properly recorded and promptly banked? • Does the precept recorded agree to the Council Tax authority's notification? • Are security controls over cash and near-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 each council meeting? • Is petty cash reimbursement carried out regularly?
Payroll Controls	• Do all employees have contracts of employment with clear terms and conditions? • Do salaries paid agree with those approved by the council? • Are other payments to employees reasonable and approved by the council? • Have PAYE/NIC been properly operated by the council as an employer?
Assets controls	• Does the council maintain a register of all material assets owned or in its care? • Are the assets and Investments registers up to date? • Do asset insurance valuations agree with those in the asset register?
Bank Reconciliation	• Is there a bank reconciliation for each account? • Is a bank reconciliation carried out regularly and in a timely fashion? • Are there any unexplained balancing entries in any reconciliation? • Is the value of investments held summarised on the reconciliation?
Year-end procedures	• Are year end accounts prepared on the correct accounting basis (Receipts and Payments or Income and Expenditure)? • Do accounts agree with the cashbook? • Is there an audit trail from underlying financial records to the accounts? • Where appropriate, have debtors and creditors been properly recorded?

Appendix 10 – Safeguarding public money

Safeguarding public money

<i>Framework to safeguard public money for local councils in England</i> Local councils must have in place safe and efficient arrangements to safeguard public money.

Framework to safeguard public money for local councils in England

Local councils must have in place safe and efficient arrangements to safeguard public money.

Where doubt exists over what constitutes money, councils must presume that it falls within the scope of this guidance.

Councils must review regularly the effectiveness of their arrangements to protect money.

Every local council must arrange for the proper administration of its financial affairs and that one of its officers has responsibility for those affairs.

Councils must identify and protect income and expenditure and the money represented by each. They must ensure controls over money are embedded in Standing Orders and Financial Regulations.

Councils must not relinquish the 'two member signatures' control over cheques and other orders for payment until they have put in place safe and efficient arrangements in accordance with this guidance.

The council must approve the setting up of and any changes to accounts with banks or other financial institutions.

The council must approve entry into a 'pooling' or 'sweep' arrangement whereby the bank periodically aggregates the council's various balances via automatic transfers.

If held, corporate credit card accounts must be set up to operate within defined limits and cleared monthly by direct debit from the main bank account.

The council must approve every bank mandate, the list of authorised signatures for each account, the limits of authority for each account signature and any amendments to mandates.

Risk assessment and internal controls must focus on the safety of the council's assets, particularly money.

Those with direct responsibility for money must undertake appropriate training from time to time.

Overview

- 1. Local councils must have in place safe and efficient arrangements to safeguard public money.** It is a general principle that more than one person should be involved in any payment, whether that is before, at or after the point at which the payment is made.
2. Regulation 4(1) of the Accounts and Audit (England) Regulations 2011 requires local councils to ensure that financial management of the council is adequate and effective. The Regulations also require councils to have a sound system of internal control which facilitates the effective exercise of its functions. This includes arrangements for the management of risk. Nowhere is this more important than when considering how councils manage money.
3. The guidance in this section helps local councils to protect the money they use to provide services for local people. It:
 - defines 'money';
 - defines 'must', 'should' and 'may' requirements;
 - describes the drivers for change from statute and technology;
 - identifies roles and responsibilities for members;
 - identifies roles and responsibilities for Responsible Finance Officers
 - describes arrangements for monitoring and scrutiny; and
 - describes controls for managing risk, error and fraud.
4. This guidance should be read in conjunction with advice issued by NALC and SLCC on Standing Orders and Financial Regulations.

What is money?

5. 'Money' includes cash and anything easily converted into cash. For example, a non-exhaustive list of money includes:
 - physical cash and notes, petty cash and unclaimed receipts, imprest accounts, cash in transit;
 - unpaid income held by debtors;
 - signed and unsigned cheques, drafts and other orders for payment;
 - current, deposit and investment accounts at banks and financial institutions and access to undrawn borrowing facilities;
 - credit cards (where held – see below), debit cards, store cards, fuel cards;
 - access to balances by telephone or electronic transfer; and
 - the ability to buy goods or services on credit.

6. **Where doubt exists over what constitutes money, councils must presume that it falls within the scope of this guidance.**

7. This guidance applies to all accounts held with financial institutions, as principal or trustee, including controls over access whether physical or electronic. 'Public money' refers to all money controlled by the council.

Definition of 'must', 'should' and 'may'

8. In this section:

- The word '**must**' means there is a specific legal or regulatory requirement affecting local councils. To help you easily identify those sections that contain a legal or regulatory requirement we have used **bold type** in that section. '**Must**' is a requirement that is essential.
- We use 'should' to identify minimum good practice, but for which there is no specific legal or regulatory requirement. Councils follow this practice unless there is a good reason not to;
- 'May' identifies practices councils apply exercising discretion.

The drivers for change

9. This guidance helps local councils to respond to key changes in the statutory and technological environment for payments.

10. The repealed Section 150(5) of the Local Government Act 1972 governed the stewardship of money by local councils. It required that 'every cheque or other order for the payment of money shall be signed by two members of the council'. Although no longer the law, this remains good practice.

11. Central government expressed the view that 'the removal of S 150(5) should not leave the public funds controlled by parish councils at any greater risk of loss through misconduct or poor control'¹ and that 'safeguards be put in place (so) that all the payments made by parish councils are legitimate and that there is no misuse of the system.'²

12. The Payments Council set out a strategic vision for UK payments³ that identified the increasing variety of payments options and accepted the long-term decline in the use of cheques. The report highlighted the advantages and risks associated with the technological progress of UK payments. It also brought into sharp focus the need for local councils to modernise their arrangements and put in place safe and efficient methods of payment for goods and services.

13. This guidance was developed by the sector to demonstrate how local councils safeguard public money within a contemporary framework.

¹ Letter dated 21 July 2010 From Rt. Hon Grant Shapps MP, Minister for Housing and Local Government to NALC, SLCC and other stakeholders.

² CLG Ministerial Statement 9 October 2010 www.communities.gov.uk/newsstories/newsroom/1735546

³ http://www.paymentscouncil.org.uk/payments_plan/

Roles and responsibilities of members

- 14. Councils must review regularly the effectiveness of their arrangements to protect money.**
15. Local council members are responsible for putting arrangements in place to safeguard public funds. Councils may delegate the role of protecting money to individuals, for example to the Clerk or the RFO, but the legal responsibility always remains with the council and its members.
16. Therefore, arrangements should:
 - demonstrate how the council meets its responsibilities;
 - support compliance with the general principle that more than one person should be involved with any payment;
 - be current; and
 - include specific duties of named individuals.
17. The duties of named individuals may include:
 - authorisation or scrutiny of payments;
 - securely managing money;
 - arranging security on and off the premises;
 - identifying internal controls; and
 - supervision measures.
18. The council may seek external advice and guidance to enhance internal expertise, skill or knowledge. Periodic reviews of arrangements may be carried out by members or by Internal Audit. Reviews should rotate and all outcomes reported to full council.

Roles and responsibilities of the Responsible Finance Officer (RFO)

- 19. Every local council must arrange for the proper administration of its financial affairs and that one of its officers has responsibility for those affairs⁴. This officer is the Responsible Financial Officer (RFO).⁵**
20. In all circumstances, even where a local council has not made a formal appointment, there is always a council RFO. By default, the RFO is whoever keeps the council's accounts. The council should appoint a temporary RFO if the appointed RFO is unavailable through absence or illness and has not nominated a member of staff to act as RFO.
21. The RFO should be familiar with statutory duties for financial administration as they apply to local councils arising from:
 - Sections 114 and 151 of the Local Government Act 1972; and
 - The Accounts and Audit Regulations 2011 ('the Regulations')
22. The responsibilities of the RFO include to advise the council on its:
 - corporate financial position;
 - key financial controls necessary to secure sound financial management; and

⁴ section 151 Local Government Act

⁵ See Practitioners' Guide paragraphs 1.22 to 1.28 and Appendix 2 for a general description of RFO responsibilities.

- treasury (that is cash and investments) management.

Corporate arrangements for monitoring and scrutiny

23. **Councils must identify and protect income and expenditure and the money represented by each. They must ensure controls over money are embedded in Standing Orders and Financial Regulations.**
24. **Councils must not relinquish the ‘two member signatures’ control over cheques and other orders for payment until they have put in place safe and efficient arrangements in accordance with this guidance.** The ‘two member signatures’ control is just one of many possible controls. By itself it does not satisfy the requirement to have in place safe and efficient arrangements for managing money.
25. **The council must approve the setting up of and any changes to accounts with banks or other financial institutions.**
26. **The council must approve entry into a ‘pooling’ or ‘sweep’ arrangement whereby the bank periodically aggregates the council’s various balances via automatic transfers.**
27. Councils should avoid the use credit cards as they are difficult to control and present unnecessary risks to public funds.
28. **If held, corporate credit card accounts must be set up to operate within defined limits and cleared monthly by direct debit from the main bank account.**
29. **The council must approve every bank mandate, the list of authorised signatures for each account, the limits of authority for each account signature and any amendments to mandates.**
30. Where multiple accounts are held, authorised signatures should not be concentrated for any length of time among just a few members but allocated widely. Authorised signatories should be rotated.
31. Councils should set out clearly in writing the responsibilities of those handling money. Where officers are to receive delegated responsibility for collecting money or making payments, their terms and conditions of employment should refer to the relevant council Standing Orders, Financial Regulations and internal controls.
32. Internal controls should include clear arrangements for the temporary holding, transit and storage of cash and clear rules about the frequency of banking. Those handling money and those with responsibilities for controls should be aware of the terms of the council’s insurance cover for money movement and security.

Corporate controls to manage risk, error and fraud

33. **Risk assessment and internal controls must focus on the safety of the council’s assets, particularly money.** Wherever possible, councils should apply and monitor a clear segregation of duties regarding money and its movements.

34. **Those with direct responsibility for money must undertake appropriate training from time to time.** Members should keep themselves informed about known risks and threats to money. Councils may engage with police and local anti-fraud and corruption networks to keep up to date with risks and security threats.
35. Fidelity Guarantee insurance or any other form of security is not by itself sufficient protection over threats to money or other assets. Risk assessed insurance should, however, always cover maximum exposure to loss of money.
36. Councils should expect to see bank reconciliation at every ordinary council meeting. In the event of bank reconciliation discrepancy, explanations should be checked and verified. The clerk should explain any failure to produce bank reconciliation.
37. The RFO should issue any cheques or other orders for payment promptly after approval by the council. Holding back cheques approved for payment by the council is discouraged and should be used sparingly. Unissued cheques are vulnerable to fraud and may create a false impression of the council's available financial resources.
38. If transfers between bank accounts are excluded from bank reconciliation, a listing of 'pooled' or 'swept' inter account transfers should be kept up to date and made available to any member on request.
39. A listing of all accounts held, their current authorised signatures and their current balances should be kept up to date and made available for any member on request.
40. Payments in respect of trade credit arrangements with local suppliers should meet government targets on proper payments.
41. Internal audit should review and report on controls over money annually.
42. Councils may from time to time request written confirmation of balances. This should be more frequent where paper statements are not received and reliance is placed on electronic information.

Appendix 11 – Declaration of No accounts



DECLARATION OF NO ACCOUNTS

LOCAL COUNCILS, INTERNAL DRAINAGE BOARDS OR OTHER SMALL BODIES IN ENGLAND WITH NO ACCOUNTS FOR THE FINANCIAL YEAR ENDED 31 MARCH 2014

«Small_Body_Name»

1. I confirm that «Small_Body_Name» received no income or made any expenditure* in the year ended 31 March 2014 and has no accounts to audit.

YES ☐ NO ☐

Note – if you answer NO you must complete a full Annual Return

2. I confirm the balance in hand as at 31 March 2014 is £_____. (Insert total from bank statement(s) + petty cash)

Return a signed copy of this Declaration to:

{[INSERT NAME AND ADDRESS of Appointed auditor]}

Signed: _____

Clerk/Responsible Finance Officer/Chair or equivalent (for parish meeting) [Delete as appropriate]

Date _____

Telephone:

Email:

Address:

* Income or expenditure includes any items with a value of £1 or more.

It is good practice to display or publish a copy of this declaration to inform local electors that there are no accounts that are subject to audit under Section 2(1) of the Audit Commission Act 1998.