Governance and Accountability for Local Councils

A Practitioners' Guide 2008 (England)

NALC

Society of Local Council Clerks
Professional Supportive Innovative

Governance [**guhv**-er-nuhns] *noun 14th Century*

How local councils ensure that they are doing the right things, in the right way, for the right people in a timely, inclusive, open, honest and accountable manner.

Accountability [uh-koun-tuh-**bil**-i-tee] *noun 1794*

Occurs when local councils that are entrusted with managing public funds to provide public services explain to their communities how they have discharged that trust.

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. It was always recognised that the Practitioners' Guide would need to be kept up to date with developments relevant to the local council sector.

Therefore, what is now the Joint Practitioners' Advisory Group (JPAG) was originally formed in September 2002 as a standing group, also with members drawn from key stakeholders, to help ensure that the guidance remains relevant to the needs of local councils 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 representatives from Wales who continue to participate as full partners in JPAG although the responsibility for producing guidance has now transferred to Wales.

Since April 2006, JPAG has expanded to include key stakeholders representing other smaller bodies in England which are required to complete an annual return. Separate guides for Local Councils and Internal Drainage Boards have now been issued by JPAG and published by their respective sector representative bodies.

The current members of the Joint Practitioners Advisory Group are as follows.

David Aldous	Audit Commission (Chair)
Alan Fairchild	Society of local Council Clerks (SLCC)
Graham Fletcher (CLG)	Department of Communities and Local Government
Sarah Steeds	Department of Food and Rural Affairs (Defra)
Phil Winrow	Environment Agency (EA)
Peter Lacey	National Association of Local Councils (NALC)
Dr Jean Venables	Association of Drainage Authorities (ADA)
Jon Tomlinson	Upper Witham Internal Drainage Board and ADA
Keeley Lund (CIPFA)	Certified Institute of Public Finance and Accounting
Alan Robertson	Clement Keys (representing audit suppliers)
Clem Collins	Audit Commission Technical Support
Mark Lewis	Audit Commission Legal Team
George Wisz	Audit Commission (Secretary)

For Wales:

Deryck Evans	Wales Audit Office
Ian Skinner	Wales Assembly Government
Simon White	One Voice Wales

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 the local council guide drew on and updated CIPFA's *Accounting Guidance Notes for Local Councils*, 1996 ('the purple book') and we are grateful to CIPFA for allowing this and for their continuing support.

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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 proper standards. 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 their managements (both members and officers) are responsible for putting in place 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, and sets out the appropriate standard of financial reporting to be followed. It represents '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

1 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.

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

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

4 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, will 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.

5 The accountability framework is ‘risk-based’. It must be 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.

6 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.

7 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 to local taxpayers internal audit and other third party reports to demonstrate their commitment to inclusiveness, openness and transparency.

Introduction

1 The purpose of this guidance is to help practitioners to understand regulatory requirements faced by local councils. It provides a guide to the accountability and audit framework and looks at how risk management, principles of good internal control and the roles of the internal and external auditors apply to local councils. The aim is to provide a source of information about accounting and audit matters affecting local councils. It is intended to be used not only by practitioners, but also by elected members and officers, accountants, internal auditors and trainers.

2 Most local councils meet their public accountability and reporting duties by completing a single document, the annual return, which is published annually by the Audit Commission (the Commission). The annual return balances the need for transparency and openness with the need to minimise the burden of public reporting. It is designed to inform taxpayers and other key stakeholders about the work and finances of their local council in as accessible a way as may be achieved while still meeting public reporting standards.

3 The accountability and audit framework applies to all local councils with either annual expenditure or annual income up to £1,000,000. The largest local councils operating above this threshold are subject to the same accounting regulations and audit approach as principal authorities and must follow the Statement of Recommended Practice (SORP)[1]. They are, therefore, currently excluded from the scope of this guidance although in Part 4 we provide some information and examples of how larger councils may approach applying the SoRP.

4 The guidance 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 the annual return and corporate governance. This takes practitioners through each of the sections of the annual return and provides guidance on good practices.
- **Part three** focuses on accounting guidance aimed at promoting good practice when preparing the statement of accounts.
- **Part four** directs larger local councils not covered by this guide and those approaching the £1 million threshold to where they may find guidance on how to apply the SoRP.
- **Appendices** provide additional information and tools for practitioners.
- A **glossary** of words and phrases commonly used is included at the end of this guidance.

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[1] The Statement of Recommended Practice (the SoRP) is available from the Chartered Institute of Public Finance and Accountancy (CIPFA)

5 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 the guidance cover all queries about the application of the accountability and audit framework as this develops over time.

6 Arrangements have, therefore, been put in place to provide technical support through the respective county and regional structures of NALC and SLCC, which are themselves supported by regular meetings of the Joint Practitioners' Advisory Group. 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.

7 For a detailed summary of the rights of individuals in relation to the accounts of local councils please see the Audit Commission's publication – *Councils Accounts Your Rights*. For those viewing this guidance electronically you may access the publication via the following Weblink http://www.audit-commission.gov.uk/reports/NATIONAL-REPORT.asp?CategoryID=&ProdID=53EEC57C-D29F-44a9-BA46-210AD5959A0C.

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 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 applies 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 to describe themselves. These alternative styles do not, however have any effect on legal powers or affect formal reporting duties.

Parish Councils

1.4 Parish Councils are currently 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 discuss 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 council has a clerk who acts as the chief officer and, depending on its size, a number of additional staff may be employed.

1.6 For most parish councils, the majority of income is derived from an annual charge, the precept, on local electors. 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, car parks etc) and in some cases from returns on investments.

1.8 In March 2003 the Government announced its initiative for accrediting councils who meet certain standards as 'Quality Councils'. This is intended to encourage more community service provision to be devolved from principal authorities to local councils, where appropriate, together with the income and expenditure associated with those services. Some legislation now distinguishes the powers available to a parish council according to its status or otherwise as a Quality Council. Certain Quality Councils meeting eligibility standards have the power to promote well-being in their communities.

Town and City Councils

1.9 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

1.10 Part 4 of this Act introduces new powers for parishes including:

- alternative styles of name such as community, village or neighbourhood council;
- appointing councillors;
- community strategies and governance reviews; and
- extension of powers of well being.

1.11 Practitioners must take care to seek advice and guidance in respect of the application of these powers.

Charter Trustees

1.12 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. The powers and duties of Charter Trustees are contained in the Charter Trustee Regulations 1996. 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.

Parish meetings

1.13 Parish meetings differ from parish councils in that they are not corporate bodies. They exist to discuss the affairs of the local community and 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.

1.14 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, is required, irrespective of size, to prepare accounts annually in the format specified in the annual return and to have an audit.

1.15 A number of parish meetings and some very small parish councils incur no financial transactions in a financial year, hold no balances and own no assets. A short form annual return caters for such cases. Local councils fulfilling this criterion should send to their appointed auditor on receipt of notification of audit, a signed short form 'no transactions' annual return supplied to them by the auditor for this purpose.

Joint committees

1.16 Schedule 2 of the Audit Commission Act 1998 identifies 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.

1.17 The management of joint committees usually is 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.

Councils' accounts and audit arrangements

1.18 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.

1.19 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.

1.20 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 accounts[2].

1.21 This guide provides access to a current copy of the Accounts and Audit Regulations 2003 as amended (the Regulations) for use as a reference tool for practitioners at Appendix 7. Practitioners are reminded of the need to make sure that they are always viewing the latest version of the regulations when considering how they should be applied.

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 must be elected annually by the council from among its members. From time to time 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.

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 they 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 a responsible financial officer (RFO) to manage their financial affairs. In many instances the clerk also holds the post of responsible financial officer. 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.

1.25 If no responsible financial officer 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.

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[2] See paragraph 7 in the Introduction section above for a link to more detailed guidance on electors' rights.

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 are required at least once a year to conduct, in accordance with proper practices, a review of the effectiveness of their system of internal control and publicly report the outcome. This annual governance review must include a separate review of internal audit. Guidance on how this review may be carried out may be found in paragraphs 2.79 to 2.96. Section 2 of the annual return provides the means for local councils to report their annual governance statement.

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 came into effect for financial years ending on or after 31 March 2002 is that it seeks to recognise the differing circumstances of local councils of different size. This is described in the flowchart at Appendix 3.

1.30 This guidance 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. Extracts from the Audit Commission's *Code of Audit Practice* can be found at Appendix 4. Key elements of the Commission's standing guidance to external auditors are reproduced at Appendix 5.

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 2005 for local government bodies* (the Code) sets the required standards for its appointed auditors. The Code, when talking about how auditors should discharge their statutory annual 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 £1,000,000 or less is a requirement under 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 and the annual return is expected to be accurate and complete when presented to the auditor. The annual return should be prepared in accordance with the proper practices presented in this guide.

'Proper practices'

1.36 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'.

1.37 In the guidance which accompanies the revised 2006 Regulations in England (see Appendix 7), CLG explains the source of the term 'proper practices', their legal standing and where they may be found. The CLG guidance states that for local councils it is this publication, *Governance and Accountability in Local Councils in England and Wales – a Practitioners ' Guide 2003*[3]*,* in which the proper practices in relation to both the accounts and internal audit may be found.

The council as trustee

1.38 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.

1.39 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.

1.40 In cases where local authorities are sole managing trustees (ie 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.

1.41 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 the annual return.

1.42 Section 1 of the annual return (the statement of accounts) requires the following disclosure: *'the council acts as sole trustee and is responsible for managing (a) trust fund(s)/assets [Yes/No]'*.

1.43 If the council has disclosed that it is a sole managing trustee it must also complete the associated assertion in section 2 of the annual return (the annual governance statement): *'in our capacity as the 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'*

1.44 Smaller relevant bodies may in this way meet the requirement of the Audit Commission Act to disclose each 'account of the body'. Auditors can plan work around these disclosures if required.

[3] As amended and its successor publications

1.45 There is no requirement for local councils to prepare consolidated or group accounts to include the charitable trust funds. Where councils have historically consolidated trust funds within the main accounts of the council, these should be excluded for reporting purposes to avoid the risk of misleading readers of the accounts.

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 the council's bank account is used to pay for any expenditure on behalf of a charity (prior to recovery from the charity account), then these transactions, including any VAT, must be included in the annual return of the council as being its own expenditure and income. However, to simplify accounting, it is recommended that a separate bank account is established for the Charity as soon as possible and that funds are never or rarely mixed. The reserves of the council should **not** include those of any charity.

1.47 Meetings of the council when it is acting as charity trustee should take place separately from those of the council acting as the council. Separate minutes must be kept. In order to avoid confusion, charity business items should always be minuted separately from council business items. 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 the trustees for a charity, in which members are meeting. The chairman should also seek to make the current capacity clear to the meeting at the outset and throughout, particularly if meetings are held one after the other or where confusion around capacity is possible.

1.49 The value of charity property should **not** be shown in the council's books of account and annual return as council property. Charity assets held 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'.

Part 2 - The annual return and corporate governance

This part looks at the annual return in more depth to provide practitioners with guidance on completing the return and submitting it to annual audit. It explains risk management, internal controls and the role of internal audit. Understanding these, and how they work together, is key to good governance and the proper completion of the annual return, and thus to the success of this approach.

Part 2 of the guidance is structured as follows.

- What is the annual return?
- The statement of accounts.
- Explaining significant variances and analytical review.
- Bank reconciliation in support of the annual return.
- Investments.
- The annual governance statement.
- The external auditor's certificate and opinion.
- Internal audit's annual report.
- 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 statement of accounts as 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 his/her 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.

2.2 The annual return is in four linked sections which should be read as a whole:

1. the statement of accounts;
2. the annual governance statement;
3. the external auditor's certificate and opinion; and
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, a copy of the three key sections (1 to 3) can be opened up and easily displayed on most notice boards.

The statement of accounts (Section 1 of the annual return)

2.4 Each local council is required by section 151 of the Local Government Act 1972 to appoint a responsible financial officer (RFO) as the person responsible for the administration of its financial affairs[4]. The annual return is the local council's statutory statement of account. 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 paragraph 2.7), 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 1.38 to 1.49).

2.5 This means that, by signing the certificate, the council's RFO is 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 required is that of the RFO at the time of approval – any new appointee will wish to take reasonable steps to ensure that the certificate is accurate.

2.6 Current rules require local councils where the gross income or expenditure (whichever is the higher) for the year 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 may be found in paragraphs 3.72 to 3.79.

2.7 Local councils operating below the £200,000 threshold may choose to report either on an income and expenditure basis or on a receipts and payments basis. However, councils that change the basis on which their accounts are presented should ensure that the comparative accounts in the annual return are shown on a consistent basis. Any change in the way that the accounts are presented, ie 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 itself is also asked to give a public assurance (see paragraphs 2.37 to 2.49) that in approving the annual statement of accounts it is satisfied that this has 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.

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[4] 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.

2.9 Alongside the RFO's certificate, the person presiding at the committee or meeting at which the approval is given is required to confirm, by signing the statement at the bottom of section 1 of the annual return, that the accounts have been approved by the council in accordance with the Regulations. Currently these require the accounts to be approved as soon as reasonably practical and in any event within three[5] months after the end of the period to which the statement of account relates. The intention behind the additional requirement for the chair of the committee or meeting to sign and date the statement of accounts is that the chair's signature formally represents 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 accounts have to be approved by 30 June. However, the further the distance between the year end and the accounts approval and publication date, the less useful the accounts are to the reader. The statutory approval date should be seen, therefore, as the latest date by which this can be given. It is good practice to complete the accounts and have them approved by the council and published as close as possible to the financial year end to which they relate.

2.11 Section 1 of the annual return standardises the presentation of accounts by local councils into a simple and easy to read format. For the benefit of both the compiler and the reader, each of the ten-line items carries a note of explanation about the intended source of the information and an explanation of how the figure is calculated.

2.12 All sections of the annual return should be completed, including writing 'nil' or '0' in any section that does not appear to apply. Leaving blank spaces 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. For auditors, such uncertainty must be eliminated, and so any unexplained omissions will lead to additional, avoidable, correspondence with the council for which additional fees will be charged.

2.13 All figures in the annual return should agree to the primary financial records of the council. The RFO must be able to show how the figures in the annual return reconcile to those in the cashbook and other primary records of accounts. Members should expect to see this reconciliation when they are asked to approve the accounts in the annual return.

2.14 More detailed accounting guidance to help support completion of the annual return is contained in Part 3.

Explaining significant variances and analytical review

2.15 One of the documents called for to accompany the annual return when it is sent by the council to the external auditor, is an explanation of significant variances in levels of expenditure and balances.

[5] Approval by 30 June applies from the financial year ending 31 March 2009. For 2008 it is 31 July.

2.16 The purpose of showing comparative annual receipts and payments or income and expenditure 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 decision making.

2.19 Analytical review can 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.

2.20 For example, an unexplained increase in precept 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 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 without an equivalent increase in capital spending and in the value of fixed assets 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 line 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.

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 annual return Box 7 does not equal annual return 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 annual return 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. It is generally accepted that general (ie un-earmarked) revenue reserves usually lie within the range of three to twelve months of gross expenditure. However, the amount of general reserve should be risk assessed and approved by the Council.

2.27 From the figures provided in the statement of accounts, 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 bank reconciliation. The bank reconciliation, which must 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 would probably lead to the council incurring additional audit work and cost which could otherwise be avoided. Further information on performing bank reconciliations is in Part 3.

Some notes about investments

2.29 It is rare for a local council to hold investments 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 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. Investments 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 comply with the Secretary of State's investment guidance for local government bodies[6] and relevant legislation[7].

2.32 In making long term investments, the council should develop an Annual Investment Strategy. If investments exceed £500,000 this is a requirement. 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 will ensure that the council has properly assessed the risk of committing funds to longer term investments.

2.33 All investments by local councils, other than in interest bearing accounts, must be identified as long-term investment and treated as capital 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 the acquisition of long-term assets is always capital expenditure that reduces available balances and reserves.

2.34 A council may also on occasion decide to support its work by making a loan to a local body. This type of investment creates a long-term asset.

2.35 When a council receives shares following a de-mutualisation of a Building Society or similar institution this also creates a long-term asset.

2.36 Part 3 below provides guidance on how councils account for and report short-term and long-term investments in the annual return.

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

2.37 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.

2.38 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.

2.39 Councils are expected to make a number of representations and assertions in eight statements of assurance, which together comprise the annual governance statement about the accountability of the council. The annual governance statement together with the statement of accounts must be approved at a full council meeting.

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[6] See Appendix 8: Local Government Investments – guidance under section 15(1)(a) of LGA2003 letter 12 March 2004

[7] In particular, Local Government Act 2003 s 16 and Regulation 25 of the Capital Finance Regulations 2003

2.40 The statements 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 have approved the statement of accounts which has been prepared in accordance with the requirements of the Accounts and Audit Regulations and proper practices.'*

2.41 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 have maintained an adequate system of internal control, including measures designed to prevent and detect fraud and corruption* ***and*** *reviewed its effectiveness.'*

2.42 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.

2.43 A more detailed discussion about internal controls, which auditors may wish to test, can be found in the section on risk management which starts at paragraph 2.97.

> 3. *'We have taken all reasonable steps to assure ourselves that there are no matters of actual or potential non-compliance with laws, regulations and codes of practice which could have a significant financial effect on the ability of the council to conduct its business or on its finances.'*
>
> 4. *'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.'*

2.44 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 the financial records and ask questions of the auditor.

2.45 The third statement confirms that the council 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 the opportunity to exercise their rights. A positive response confirms that the council has also complied with the codes of practice which it has endorsed and adopted to regulate the way in which it carries out its business.

5. *'We have carried out an assessment of the risks facing the council* ***and*** *taken appropriate steps to manage those risks, including the introduction of internal controls and/or external insurance cover where required.'*
6. *'We have maintained throughout the year an adequate and effective system of internal audit of the council's accounting records and control systems* ***and*** *carried out a review of its effectiveness.'*
7. *'We have taken appropriate action on all matters raised in reports from internal and external audit.'*

2.46 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 (see risk management section below) covering:

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

2.47 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.

2.48 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 - in our capacity as the 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.'*

2.49 This representation is used by councils that act as sole managing trustee of trust funds or assets who have already answered 'Yes' to the note in section 1. This statement confirms that the sole managing trustee has complied with Charities Acts, has arranged for an audit or independent examination of the trust's accounts (if required) and has completed all appropriate returns to the Charity Commission.

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

2.50 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.

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

2.52 The auditor's report contains an opinion on the accounts. This must 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 £1,000,000 threshold. Councils maintaining sound internal controls and other governance arrangements means that the amount of work required from external auditors to fulfil their statutory duty can be correspondingly reduced to a proportionate level.

2.53 While in most cases the 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 means that 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 that may have been raised in previous years as well as to reports from internal audit.

2.54 If the auditor modifies the opinion in any way this is 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.

2.55 Practitioners are reminded that to be awarded Quality Parish or Town council status, there is a requirement that the council's statement of account bears an unqualified opinion given by the external auditor.

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 If internal controls within local councils are inadequate, there is an increased risk of error, mistake and fraud. Local councils should consider this as part of its 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 Regulations 2003 as amended 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'. CLG's *Guidance on the Accounts and Audit Regulations 2003*[8] explains that for local councils the non-statutory proper practices in relation to internal control may be found in 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 whether the systems of financial and other controls over a councils activities and operating procedures are effective. It is essential that the internal audit function is sufficiently independent of the other financial controls and procedures of the council which are the subject of review. The person or persons carrying out internal audit must also be competent to carry out the role in a way that will meet the business needs of each local council.

2.60 Internal audit is an ongoing function reporting to the council at least once a year. It is not, however, one that should be carried out only once each financial year; nor does it have to be carried out only at the completion of each financial year-end. It is undertaken 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. It is the periodic independent review of a council's internal controls resulting in an assurance report 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 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 sets out its control objectives, usually in the form of standing orders and/or 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 will be.

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[8] CLG Circular 03/2006 issued 18 August 2006 – see Appendix 7

2.64 It is a matter for the council to determine the necessary scope and extent of its internal audit, and when securing an internal audit service, to 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). As stated above, it is for each local council to determine how best to meet the legal requirement for internal audit having regard to its business needs and circumstances.

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 County Association of Local Councils or Branch of the Society of Local Council Clerks. 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 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 practical examples of how local councils have secured internal audit see paragraph 2.71.

2.66 Local councils will 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 ensure are met by their internal audit function, regardless of how procured. These principles are independence and competence.

2.67 Independence means that whoever carries out the internal audit role must not have any involvement in the financial decision making, management or control of the council, ie the council’s financial controls and procedures. It follows, for example, that the circumstances in which a member of a council can demonstrate that they are sufficiently independent of the financial decision making and procedures of the council are difficult to envisage, since such a member would need to exclude themselves 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 accounting, preparation of financial statements or the annual return, to be appointed as internal audit. Particular care should be taken to avoid conflicts of interest in cases where an external provider of accounting software is engaged who also offers internal audit services through an associate company, firm or individual.

2.69 Those charged with carrying out internal audit should not be asked to offer consultancy or advice on the council's financial controls and procedures. 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.

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

- understanding of basic accounting processes;
- understanding of the role of internal audit in reviewing systems rather than undertaking detailed checks that are more appropriately the responsibility of management;
- awareness of risk management issues; and
- understanding of accounting requirements of 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 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[1];
- local panels of officers (usually clerks) providing internal audit services to each other and sometimes wider afield[1];
- 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 local NALC 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, in a very positive and welcome development, a number of district council have offered, under their community development budgets, to provide training and support for potential internal auditors for local councils.

[1]Subject to the guidance that one to one reciprocal arrangements between councils are unlikely to be seen as being sufficiently independent to satisfy this requirement.

2.72 The duties of internal audit relate to reporting to the council on the adequacy of systems of control. Internal audit's annual report may be found at section 4 of the annual return but the guidance given within the annual return is necessarily brief.

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 at 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.
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.

	Subject	Guidance
2	Financial Regulations Standing Orders Payment Controls	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 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.

	Subject	Guidance
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 2.97.
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, paragraph 3.29 onwards.

	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 these 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.

	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'. If a 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 (ie 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 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 to have a 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) would normally require formal agreement by council, committee or less frequently the RFO, as well as a written statement for the employee. The council should record evidence of such agreement. Internal audit should check that this evidence is in place and would agree sums paid to those 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.

	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 the 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 require verification on a regular basis. This verification should include confirmation that insurance cover is adequate and sufficient. If investments are held then 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 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 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.

	Subject	Guidance
9	Bank reconciliation	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 financial 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 that 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. In producing year-end financial statements there is a need to consider proper valuation of assets and liabilities. A system will be in place for identifying outstanding amounts (receivable and payable) and then for deciding on their materiality for inclusion in the income and expenditure accounts. 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 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 auditor's role is to assist the council in fulfilling its responsibility to have and maintain proper arrangements 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 and work.

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. All such work is to be reported to council. Any report by internal audit is addressed to the council, may suggest actions by the council, and should be treated as a document open to view by local taxpayers.

2.78 A possible approach to testing by internal auditors is contained in Appendix 9 to this guidance. This is not a checklist requiring completion, but a suggested method of approach.

The review of the system of internal audit

What does the law say you have to do?

2.79 The regulations require councils to carry out an annual review of the effectiveness of their system of internal audit. This review is an integral part of continually improving governance and accountability.

2.80 Local councils must at least once a year carry out a review of internal audit and include the results in the annual governance statement which is Part 2 of the annual return.

2.81 The review must be balanced to 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 must judge the extent and scope of the review by reference to their own individual circumstances.

So what needs to be reviewed?

2.82 Regulation 6 requires, as a primary matter, that a council '*shall maintain in accordance with proper practices an adequate and effective system of internal audit of its accounting records and system of internal control*'.

2.83 Local councils source their internal audit in a number of ways (which are described elsewhere in this guide). The starting point for the review should be an assessment against the internal audit standards set out in paragraphs 2.58 to 2.78. This will 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?

2.84 A key point to note is that it is the responsibility of the council to conduct the annual review. 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.

2.85 Although the internal audit provider cannot be allowed to influence the direction or extent of the review, it is considered good practice to seek their input into the process.

2.86 There are no hard and fast rules as to 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. Whichever way the review is carried out the results must be reported to and considered by a full meeting of the members of the council because of the link to the council's Annual Governance Statement.

2.87 There is no single approach that will suit all local councils. Much will depend upon the size of the council and arrangements already in place for conducting the wider review of the system of internal control and risk management generally.

What should the review cover?

2.88 Areas for review should be based around the components of internal audit which are identified in paragraph 2.83. 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.

2.89 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 ie reliable assurance about the council's internal controls and its management of risk.

2.90 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.

What evidence can be used?

2.91 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 including Quality Parish assessments.

What is the outcome of the review?

2.92 The review of the effectiveness of internal audit cannot be considered in isolation as it feeds into the council's review of the wider system of internal control. The report on the review must, therefore, include an opinion as to whether or not the internal audit system is effective.

2.93 Aside from the need to publicly report the outcome of the review, if there are any areas identified for development or change in internal audit, an action plan should be produced so that the council can 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?

2.94 Just as the Annual Governance Statement needs to be considered throughout the year, the review of internal audit should not be left until the year-end. The review feeds into the Annual Governance Statement and so it needs to be completed first. So councils must allow time for the review in drawing up their timetable for the completion of the annual return.

2.95 Monitoring of action plans to address weaknesses identified in the previous year's review should also happen throughout the year, linked to the way that the Annual Governance Statement action plan is continuously monitored.

Is training available?

2.96 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.

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].		

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.		
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

2.97 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 increasingly recognised as being central to their strategic management.

2.98 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.

2.99 Risk management is not just about financial management; it is about ensuring 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.

2.100 The local council audit approach seeks to encourage 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.

2.101 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 service improvement agenda, including, for example, Quality Parishes and encouraging the delegation of service delivery associated with attaining Quality status. Local authorities currently face pressures, including those associated with the powers around well-being, that potentially give rise to a range of new and complex risks and which suggest that risk management is more important now than at any other time.

2.102 Members are ultimately responsible for risk management because risks threaten the achievement of policy objectives. As a minimum, at least once each year members should:

- 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.

2.103 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 do this. The range, nature, complexity and scale of the business of councils vary. Similarly the priorities and service delivery objectives of one council will differ from those of others. For this reason each council must identify, for itself, the key risks to achieving successfully its priorities and service objectives. Identifying risks can be a daunting task and so 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.

2.104 Support for councils wishing to improve their risk management arrangements, over and above that provided by this guidance, is available through training available from the technical support teams of both NALC and SLCC directly, and/or the council's insurance provider and by reference to various elements of the National Training Strategy.

2.105 One reason why risk identification can be 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.

2.106 For example, a single large capital project will present a number of individual 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.

2.107 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 if, for example, if this impedes the council's ability to bid for funds in future.

2.108 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.

2.109 After identifying and evaluating risks councils need to decide upon 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 guidance.

2.110 The council's internal auditor 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 council in respect of identified risks are also set out in the three tables at the end of this section.

2.111 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:

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

2.112 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.
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 may 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.

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 there may be a need to self-manage risk

Risk identification
There are a number of activities that create business risks but do not fall easily into either of the above categories for a number of reasons, principally because they are either difficult to quantify or considered inefficient to have provided externally or just uninsurable. ✓ Keeping proper financial records in accordance with statutory requirements. ✓ Ensuring all business activities are within legal powers applicable to local councils. ✓ Complying with restrictions on borrowing. ✓ Ensuring that all requirements are met under employment law and regulations. ✓ Ensuring all requirements are met under HM Revenue and Customs Notices and regulations (Income Tax, National Insurance and VAT). ✓ Ensuring the adequacy of the annual precept within sound budgeting arrangements. ✓ Monitoring of performance against agreed standards under partnership agreements.

Internal controls
✓ Ensuring the proper use of funds granted to local community bodies under specific powers or under section 137. ✓ Proper, timely and accurate reporting of council business in the minutes. ✓ Responding to electors wishing to exercise their rights of inspection. ✓ Meeting the laid down timetables when responding to consultation invitation. ✓ Meeting the requirements for Quality parish status or other accreditation. ✓ Proper document control. ✓ Register of Members' Interests and Gifts and Hospitality in place, complete, accurate and up to date.
A council's internal controls may include the following. ✓ 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 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.

Internal controls
✓ Documented procedures to deal with enquiries from the public. ✓ Documented procedures to deal with responses to consultation requests. ✓ Monitoring arrangements by the council regarding Quality Council status. ✓ 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.
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 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 statement of accounts (in the form of section 1 of the Audit Commission annual return.) It is structured as follows.

- Introduction.
- Routine financial procedures.
- Procedures for prompt and accurate recording of transactions.
- The budgeting process.
- Capital budgeting.
- The Cash Book.
- Preparing the Audit Commission 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 statement of accounts (ie section 1 of the Audit Commission’s annual return).

3.2 Manually kept books of account, or an effective computerised accounting system, provide the basis for the statement of accounts, in that the statement of accounts is 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:

- 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: eg buildings, vehicles, investments, cash) and the liabilities that it owes (eg 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 must 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 responsible financial officer;
- the responsible financial officer 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;
- the accounting records are sufficient to show the body's transactions and to enable the responsible financial officer to ensure that the statement of accounts complies with the Accounts and Audit Regulations;
- 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, any grant or subsidy from the Government; and
- 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 uncollectable amounts, including bad debts, not to be written off except with the approval of members, or under delegated authority, the responsible financial officer, 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 that should be maintained by local councils.

3.5 All local councils, including parish meetings where there is no parish council, have a statutory duty under section 151 of the Local Government Act 1972 to appoint an officer to be responsible for the financial administration of the council. The responsible financial officer (RFO) is often also the clerk to the council, but this is not automatically the case. The council must formally determine in who the responsibility is to vest recognising that there are particular risks that arise in the unusual circumstances where an elected member is appointed (unpaid) to this office. Decisions about appointing and RFO should always be the subject of a full risk assessment and consideration evidenced by council minute. The proper segregation of duties means that the Chairman of Council or a Finance Committee should never be appointed (even on a short-term basis) either as Clerk and/or as RFO.

3.6 The appointment of a responsible financial officer 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 responsible financial officer 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 responsible financial officer and suggests the arrangements that might be put in place to ensure that these duties are met.

Statutory duty	**Possible arrangements**
1 The responsible financial officer 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 must facilitate this duty by ensuring that the officer 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 responsible financial officer 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 guidance.

Statutory duty	Possible arrangements
2 The responsible finance officer 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.	• 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 to be in place to inform the responsible financial officer 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 responsible financial officer to ensure that the statement of accounts complies with the Accounts and Audit Regulations.	• The responsible financial officer 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 statement of accounts complies with the Accounts and Audit Regulations, if they allow the analysis of transactions in accordance with section 1 of the Audit Commission annual return.

<table>
<tr><th>Statutory duty</th><th>Possible arrangements</th></tr>
<tr><td>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 government.</td><td>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.</td></tr>
<tr><td>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;</td><td>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.</td></tr>
</table>

Statutory duty	Possible arrangements
• 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 uncollectable amounts, including bad debts, not to be written off except with the approval of the responsible financial officer and for the approval to be shown in the accounting records.	

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 The payment process should always be carried out in accordance with the council's own Financial Regulations. Once the invoices have been approved, cheques or any other order for payment must, by law, be signed by two members of the council. In addition to the members signing, the clerk or responsible financial officer may also be required to sign cheques or other similar bank instructions. 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 must 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 (ie 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 responsible financial officer. Anyone handling cash on behalf of the council should be properly trained in the procedure that they are to operate. They must 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

3.16 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).

3.17 Before finalising and adopting procedures and internal control systems involving cash, the responsible financial officer 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.

3.18 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. 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

3.19 Effective debt collection is an essential part of proper financial management. Local councils need to ensure that invoices raised are paid promptly or that appropriate recovery action has been taken. Additionally, debts shown to be unrecoverable should be written off, after full consideration of the possibilities for and the likely costs of pursuing the debt.

3.20 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, the 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.

3.21 At the end of each year, the record will need to be reconciled to ensure that the figures for arrears brought forward plus new amounts due, less new receipts and write-offs, balances to the arrears that need to be carried forward into the next year's accounts.

Payroll

3.22 The remuneration payable to all staff must be approved in advance by the council. Guidance on this issue is issued jointly by the National Association of Local Councils and the Society of Local Council Clerks and should be referred to.

3.23 Local councils with **any** employees are, by definition, employers and are, therefore, required to operate under Pay as You Earn (PAYE) rules from HM Revenue and Customs. PAYE taxes and National Insurance contributions should be deducted in every instance unless authority not to do so has been received from HM Revenue and Customs in writing. Such deductions should be passed on to the Collector of Taxes on or before the date prescribed. In addition the general requirements of the Employment Acts apply (written statements, holiday and similar which are not within the scope of this guidance).

3.24 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. It is unlikely that the function of clerk to a local council in England can ever be self-employed.

3.25 As part of risk management, written confirmation should always be sought from HM Revenue and Customs to ensure that payments for services 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, eg members, which should also be considered as falling within the scope of PAYE.

Insurance

3.26 All local council employers are required by law to take out employers' liability and fidelity guarantee insurance and all cover should be kept under constant review making sure it adequately reflects changes in circumstances.

3.27 Adequate insurance against third party risks is vital especially if a local council owns property such as bus shelters, swimming pools and playground equipment.

3.28 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

3.29 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.

3.30 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.

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

1 Deciding the form of the budget	The first decision that a council must take is 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 (eg 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 (eg 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 budgeted for again (eg 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 (eg 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.
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 – eg 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.
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.

6 Provide for contingencies and consider the need for balances (continued)	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 paragraph 2.26 for guidance on the level of un-earmarked general revenue reserves. 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, ie 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 responsible financial officer, 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 responsible financial officer 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.
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 the 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

3.32 Councils can only use receipts from the sale of fixed assets (‘capital receipts’) in excess of a *de minimis* value for specified purposes, of which the main ones are the repayment of external debt and the financing of capital payments. Capital payments relate to the acquisition, construction and enhancement of land, buildings, vehicles, plant and equipment; the provision of grant-aid for such expenditure by another body will, in many cases, also be within the definition of capital expenditure. This work generally involves high levels of payments that need to be properly planned over an appropriate timescale. It is unlikely that the majority of smaller councils will embark on many major capital schemes, but where they do they should have a long-term capital budget or a rolling capital programme. Advice should be sought from NALC or SLCC where a capital receipt is to be realised.

3.33 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 the precept will have to be considered. Councils should be aware of the revenue budget implications of undertaking capital projects, including the impact on audit fees.

The Cash Book

3.34 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 therefore takes time to catch up with the actual cash flows of the council and cannot provide an up-to-date position.

3.35 The cash book therefore provides the day-to-day 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 council's finances, it can be kept in a notebook, a ledger, or on a computer spreadsheet or by using a specialist accounting package.

3.36 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.

3.37 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. This system is helpful because:
  - it has an element of internal check in it, because, 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;
  - it is particularly useful for separating out the reclaimable VAT elements of receipts and payments for the preparation of claims for reimbursement by HM Revenue and Customs; 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.

3.38 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 £25.75 and £16.80 respectively (ie net of 17.5 per cent VAT) and for reclaimable input VAT of £7.45.

3.39 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.

3.40 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.

3.41 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 would be 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.

3.42 These cancelled cheque procedures, if followed, will allow the process of balancing the cash book (see paragraphs 3.59 - 3.60) to take place most easily.

Reporting investments

3.43 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 annual return Box 8 - *Total cash and short-term investments*. Auditors may wish to confirm these account balances from time to time.

3.44 The council may also hold long-term investments (see paragraphs 2.29 to 2.36 on how to distinguish short-term and long-term investments). On acquisition, long-term investments should be recorded in the cash book as capital expenditure and will therefore appear as part of the annual return 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 therefore appear within the sum at annual return Box 9 – *Total fixed assets and long term assets.*

3.45 Each asset owned by the council should be recorded on the asset register at its original purchase cost. In the event that the original purchase cost is not known at the time of first recording on the asset register, the council should, having taken appropriate advice, establish a current value for the asset. This value will act as a proxy for the original purchase cost and remain unchanged until disposal.

3.46 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 market value of each investment at 31 March to inform readers. However, any gain or loss as compared to purchase cost will only ever be accounted for at the time of disposal when the total proceeds will be included in annual return Box 3.

3.47 Any dividend or interest payments received during the year from these investments should be recorded as income and reported in annual return Box 3 – *Total other receipts.*

3.48 When the council has incurred expenditure by giving a loan, grant or other financial assistance to a body this transaction should also be recorded as a capital expenditure item in the cash book. Any loan made must also be added to the asset register.

3.49 The outstanding amount of any loan at 31 March each year, excluding interest, falls to be reported in the sum of annual return 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 annual return Box 3 – *Total other receipts*. This receipt will also be reflected as an increase in annual return Box 7 - *Balances carried forward*. Any repayments of loan principal must also be applied to reduce the amount of the loan outstanding on the asset register.

Reconciling the cash book to the bank statement

3.50 Bank statements 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 (eg cheques drawn properly have been known to be altered by recipients before being banked.)

3.51 Bank reconciliation 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.

3.52 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, line 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.

3.53 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 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.

3.54 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 in to 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 in to 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.

3.55 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).

<u>Bank Reconciliation</u>		
Council Name ___________________________________		
Financial year ending 31 March 20xx		
Prepared by____________________(Name and role [clerk/RFO etc]) Date_________		
Approved by:___________________(Name and Role RFO/Chair of Finance, etc) Date_________		
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	
		14,010.00
Less: any unpresented cheques at 31 March (normally only current account)		
Cheque number 000154 000157 000158	(40.00) (18.00) (2.00)	(60.00)
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**
The net balances reconcile to the Cash Book (receipts and payments account) for the year, as follows		
<u>CASH BOOK</u>		
Opening Balance Add: Receipts in the year Less: Payments in the year		15,280.00 6,500.00 (7,800.00)
Closing balance per cash book [receipts and payments book] as at 31 March 20xx (must equal net bank balances above)		**13,980.00**

3.56 The procedure for preparing the bank reconciliation will usually be:

- 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.

3.57 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.

3.58 Practitioners should note that transfers between bank accounts are neither receipts nor payments and should not be included in the totals of receipts and payments in the cashbook and therefore excluded from Boxes 3 and 6 of section 1 of the annual return.

Balancing the cash book

3.59 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.

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

- 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 (ie 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

3.61 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, play equipment, plant, office equipment and vehicles etc. Long-term investments which are capital expenditure (see paragraph 2.29 to 2.35) create a non-current asset which must also be accounted for in the asset register. See paragraph 3.43 to 3.49 on how to report long-term investments.

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

3.63 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.

3.64 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.

3.65 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 under utilised 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.

3.66 The key information needed in the asset register is:

- 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;
- 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.

3.67 Most assets will be first recorded in the asset register at their purchase cost. In some cases this may not be known and a proxy cost substituted, usually the insurance value, or, where the asset is land or is not insured, a value estimated by the council based on external advice. Whatever valuation basis is adopted, it is essential that the basis is applied consistently. If for some reason the council decides that the basis of valuation is to be changed, the figures shown on the annual return the previous year should also be changed to the same new basis and marked as 'RESTATED'. The council must provide an explanation for the change to the external auditor.

Preparing the Audit Commission annual return

3.68 Section 1 of the Audit Commission annual return represents the statutory statement of accounts that councils will be 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

3.69 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).

3.70 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.

3.71 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 the 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		-
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 investment	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 £1 million, or for those electing to report income and expenditure

3.72 For councils with annual turnover between £200,000 and £1 million the annual return has to 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).

3.73 For example, suppose 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.

3.74 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 (ie 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 would not then count as income in the old financial year and would be treated as a prepayment to be accounted for in the new financial year.

3.75 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.

3.76 Very few councils will actually maintain their books of account on an income and expenditure basis. The cash book will be the main focus for day-to-day accounting and balancing off and 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 be made in the cash book for this activity only when cheques and cash are actually received.

3.77 This means that there will need to be a special exercise 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.

3.78 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: • *deduct* the amount of debtors brought into the calculation of income for the previous year; and • *add* 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: • *add* the amount of receipts in advance excluded from the calculation of income for the previous year; and • *deduct* 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: • *deduct* the amount of creditors brought into the calculation of expenditure for the previous year; and • *add* the amount of creditors outstanding 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: • *add* the amount of prepayments excluded from the calculation of expenditure for the previous year; and • *deduct* the amount of prepayments made at the end of this year.
Stock: consumable goods (eg 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: • *add* the amount of stock brought forward as an asset from the previous year; and • *deduct* 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 (eg 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: • *add* the value of any provision that needs to be made for events taking place in this year; and • *deduct* 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.

3.79 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;
- 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

3.80 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 statement of accounts 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 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, 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 statement of accounts is 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

3.81 For councils reporting on the receipts and payments basis, the amount of VAT charged to 'customers' and the VAT refund made by HM Revenue and Customs will be included in line 3 (other receipts); the amount of VAT paid to suppliers and any paid to HM Revenue and Customs will be included in line 6 (other payments).

3.82 For councils reporting on the income and expenditure basis the amounts of VAT collected from customers, paid to suppliers, and payable to, or repayable by, HM Revenue and Customs will be posted to a Creditor Account which will result in a balance due to, or from, HM Revenue and Customs. This balance will be included in Creditors or Debtors as appropriate – ie 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

3.83 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 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.
Stock	• 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.

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

		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*

3.84 As a check that the income and expenditure figures have been properly prepared, councils should agree the balance carried forward in line 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)	1,334
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

3.85 The other entries in section 1 of the annual return will be compiled separately from the income and expenditure exercise.

8	Total cash and short-term investments	For most councils, this line will be identical to 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.
9	Total fixed assets and long-term investments	This should be the value of all fixed (ie non-current) assets recorded in the asset register including any long-term investments (see paragraph 3.61). For instance, the council might have invested surplus funds in Government securities, and the purchase of these would have been accounted for as if it were 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 cost value of these investments (as recorded in the schedule of assets and investments) should be included in this line.

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 Public Works Loan Board. Instalment finance, including HP or leases which have not been classed as borrowing by CLG, should not be included here. The amount borrowed at 31 March should be easily calculated by reference to official loan schedules.

3.86 The annual return requires supporting documentation for the accounts 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 detail of 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.

3.87 The other supporting documentation required to accompany the annual return is a brief 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 will be able to remove this doubt by providing explanations for the differences between this year and last year.

3.88 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 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, ie 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.

3.89 The important thing about such information notes is that they should remove doubts about possible errors or omissions, and they therefore need to 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 the question as to why the hours had risen this year.

3.90 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.

3.91 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.

3.92 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 (eg number of hall bookings) has risen or fallen between the two years or where prices have not changed in line with inflation (eg 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 (eg 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 (eg running expenses for a newly opened one stop shop facility).

Audit Notices and the presentation of the annual return

3.93 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 *Councils Accounts Your Rights.*

3.94 These opportunities for scrutiny cover both the books of account and the statement of accounts, but are restricted to particular times. Although councils are not required to open their books on request, increasingly there is a move towards their doing so in pursuit of demonstrating openness and transparency.

3.95 The particular things that the council must do to facilitate public 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.

3.96 The council's appointed 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 usually be agreed with the responsible financial officer before the auditor's notice of audit 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, has been received must be displayed when it has been received. The auditor's certificate is in section 3 of the annual return.

3.97 The council has to 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.

3.98 Councils are therefore recommended to read the requirements of the Accounts and Audit Regulations for themselves, and use this guidance only to provide support for the conclusions they arrive at themselves as to what the Regulations require then to do. Where there is doubt, councils should consider taking legal advice.

3.99 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 (eg failure to advertise the audit), they may be willing to comment on issues that the council is having difficulty resolving.

3.100 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). For advice on balancing and reconciling the cash book, see paragraphs 3.59 to 3.60. For advice on preparing income and expenditure adjustments, see paragraphs 3.72 to 3.79.
3	Draw up Statement of Accounts and Annual Governance Statement	From 2008/09, the latest date for approval (see step 6) of the annual return is 30 June. Ensure receipt of current year annual return from the external auditor in good time and make arrangements for the necessary committee and/or full council meeting to approve the accounts.
4	Receive confirmation of the date of audit with the auditor	As part of their statutory responsibilities, the external auditor has to appoint a 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.

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 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 that it is remains displayed for the whole period up to the date of audit. The council will 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.

Step	Task	Comments
6	Submit the completed annual return to the council for approval	Regulation 10(2) requires the responsible financial officer to sign and date the statement of accounts, 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 responsible financial officer confirming that the statement of accounts is correct. This certification is required from the post holder at the time of approval. After certification, regulation 10(4) requires that the accounts are approved by a meeting of the council (or one of its committees) and that the person presiding at that meeting signs and dates 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 10(4) (a) also requires that this must be done as soon as reasonably practical and by 30 June at the latest. If a Council is unable to approve the accounts by 30 June then, according to regulation 10(6) it must: a) within 20 working days of 30 June hold a meeting of the Council to consider the annual return; and b) if the meeting cannot agree to approve the accounts the Council shall publish a statement explaining the reasons why it cannot approve the accounts.

Step	Task	Comments
7	Make the statement of accounts and other documents available for inspection	Regulation 14 requires the accounts and all books, deeds, contracts, bills, vouchers and receipts relating to them to be 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 inspection period has to be completed before the auditor’s appointed date for audit.

Step	Task	Comments
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 responsible financial officer will be available to assist the auditor. The Audit Commission provides guidance to external auditors which may be viewed at Appendix 5.
9	Publish the statement of accounts	Regulation 12(1) states that as soon as reasonably possible after the completion of the audit but no later than September 30, the local council should publish its statement of accounts and the auditor's certificate. This requirement can be met by displaying sections 1 to 3 of the annual return. Copies 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 accounts have been published 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. CLG’s guidance circular (03/2006) clarifies what is meant by ‘publication’ in Regulation 12 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 statement of accounts to persons who have not expressed an interest in receiving them, it does require positive action.

Step	Task	Comments
9 cont.		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.
10	At the conclusion of the audit, display a notice of public rights	Regulation 18 requires that as soon as possible after the auditor has certified that the audit is completed the council should for at least 14 days display a notice in a conspicuous place that the audit has been completed and that the statement of accounts (sections 1 to 3 of the annual return) is available for inspection. The statement of accounts that is 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 statement of accounts and auditor's reports; and • state the address at which and the hours during which the statement of accounts and auditor's reports are available for the exercise of these rights.

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		1,008.75											
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		
31 May	Grant from Sports Council	17	100.00				100.00							
	sub-totals for the period		1,110.37	784.99	400.00	600.00	100.00	200.00	32.08	250.00	268.27	34.64	-	10.37
	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.

Example 2 Schedule of Assets

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 Pastorale 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 18th birthday~~	~~Invoice 00046~~	~~10 June 20xx~~	~~£150~~	~~Clerk~~	Paid in full 29 June 20xx
009	Investment – (sale of allotment) Treasury Stock 5% 2014	Certificate No XP 45/003 lodged with Bank	19 August 20xx	£40,000	RFO for Investment panel	

Notes

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 (eg for bar supplies); and
- debtors ledgers (eg for allotment rentals).

In determining the layout needed, the objectives to keep in mind are that the schedule should help the council:

- 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.

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 Jul20xx	Invoice BL489	Second interim payment to Bodgers Ltd	17,816
8 Sept 20xx	Advice	Contribution from Philanthropy International 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 - Directions for Larger Local Councils (£1 million +) and those approaching the threshold

Local Councils where the greater of income or expenditure for the year exceeds £1 million for three consecutive years must, from the third year onwards, prepare accounts in accordance with the proper accounting practices found in the CIPFA Statement of Recommended Practice (the SoRP) for the appropriate financial year.

Larger councils should not underestimate the changes to their arrangements that will occur on crossing this financial threshold.

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 SoRP from year two onwards.

NALC and the former 41 Group of larger local councils prepared a commentary on the SoRP for larger councils providing examples of how they may meet the varying requirements.

The commentary does not in itself provide a source of proper practice. That is contained within the SoRP and supporting guidance. The commentary is intended to provide practitioners with examples of how larger local councils may meet their statutory responsibilities most effectively, particularly in relation to the preparation of the statement of accounts.

The commentary also contains helpful information on how councils may best prepare themselves for the significant changes, including resource and skills requirements.

It is structured in two distinct parts:

- an introduction for members and non-accounting staff; and
- detailed examples of how practitioners meet the requirements of the SoRP.

Councils wishing to obtain a copy of the commentary should contact their local NALC County Secretary.

Appendix 1 - Local council services and powers

Function	**Powers and Duties**	**Statutory Provisions**
Allotments	Powers to provide allotments. Duty to provide allotment gardens if demand unsatisfied.	Smallholdings and Allotments Act 1908, ss 25, 26 and 42. s.23.
Baths and Washhouses	Power to provide public baths and washhouses. Power to provide bathing places.	Public Health Act 1936, ss 221, 222, 223 and 227. Local Government (Miscellaneous Provisions) Act 1976 s.19.
Burial grounds, cemeteries, crematoria and closed churchyards	Power to acquire and maintain. Power to provide. Power to agree to maintain monuments and memorials. Power to contribute towards expenses of cemeteries. General management powers.	Open Spaces Act 1906, ss 9 and 10; Local Government Act 1972, s.214. Parish Councils and Burial Authorities (Miscellaneous Provisions) Act 1970, s.1. Local Government Act 1972, s.215(6). Local Authorities Cemetery Orders 1977 and 1986.
Bus Shelters	Power to provide and maintain shelters.	Local Government (Miscellaneous Provisions) Act 1953, s.4. Parish Councils Act 1957, s1.
Bye Laws	Power to make bye-laws in regard to pleasure grounds. Cycle Parks. Baths and Washhouses. Open spaces and burial grounds. Mortuaries and post-mortem rooms.	Public Health Act 1875, s.164. Road Traffic Regulation Act 1984, s.57(7). Public Health Act 1936, s.223. Open Spaces Act 1906, s.15. Public Health Act 1936, s.198.
Charities	Duties re parochial charities.	Charities Act 2003 s.79.

Function	Powers and Duties	Statutory Provisions
Clocks	Power to provide public clocks.	Parish Councils Act 1957, s.2.
Closed Churchyards	Powers as to maintenance.	Local Government Act 1972, s.215.
Commons and common pastures	Powers in relation to enclosure, as to regulation and management, and as to providing common pasture.	Enclosure Act 1845; Local Government Act 1894, s.8(4); Smallholdings and Allotments Act 1908, s.34.
Conference facilities	Power to provide and encourage the use of facilities.	Local Government Act 1972, s.144.
Community centres	Power to provide and equip buildings for use of clubs having athletic, social or recreational objectives.	Local Government (Miscellaneous Provisions) Act 1976, s.19.
Community Transport	Various – see Transport below.	Local Government and Rating Act 1997.
Crime prevention	Powers to spend money on various crime prevention measures.	Local Government and Rating Act 1997, s.31.
Drainage	Power to deal with ponds and ditches.	Public Health Act 1936, s.260.
Entertainment and the arts	Provision of entertainment and support of the arts.	Local Government Act 1972, s.145.
Gifts	Power to accept.	Local Government Act 1972, s.139.

Function	Powers and Duties	Statutory Provisions
Highways	Power to repair and maintain public footpaths and bridle-ways. Power to light roads and public places. Provision of litter bins. Power to provide parking places for vehicles, bicycles and motor-cycles. Power to enter into agreement as to dedication and widening. Power to provide roadside seats and shelters, and bus shelters. Consent of parish council required for ending maintenance of highway at public expense, or for stopping up or diversion of highway. Power to complain to district councils as to protection of rights of way and roadside wastes. Power to provide traffic signs and other notices. Power to plant trees etc. and to maintain roadside verges.	Highways Act 1980, ss.43, 50. Parish Councils Act 1957, s.3; and Highways Act 1980, s.301. Litter Act 1983, ss.5, 6. Road Traffic Regulation Act 1984, ss.57, 63. Highways Act 1980, ss.30, 72. Parish Councils Act 1957, s.1. Highways Act 1980, ss 47, 116. Highways Act 1980, s.130. Road Traffic Regulation Act 1984, s.72. Highways Act 1980, s.96.
Investments	Power to participate in schemes of collective investment.	Trustee Investments Act 1961. s.11.
Joint Committees	Power to form and participate in joint arrangements for services.	Local Government Act 1972, s101 and s102.
Land	Power to acquire by agreement, to appropriate, to dispose of land Power to accept gifts of land.	Local Government Act 1972, ss.124, 126, 127. Local Government Act 1972, s.139.
Litter	Provision of receptacles.	Litter Act 1983, ss.5, 6.
Local Energy saving measures	Power to encourage or promote microgeneration etc.	Climate Change and Sustainable Energy Act 2006, s.20.
Lotteries	Powers to promote.	Lotteries and Amusements Act 1976, s.7.
Markets	Power to establish or acquire.	Food Act 1984, s.50.

Function	Powers and Duties	Statutory Provisions
Mortuaries and post mortem rooms	Powers to provide mortuaries and post mortem rooms.	Public Health Act 1936, s.198.
Nuisances	Power to deal with offensive ditches.	Public Health Act 1936, s.260. Public Health Act 1875, s.164.
Open spaces	Power to acquire land and maintain. Power to light.	Open Spaces Act 1906, ss 9 and 10. Open Spaces Act 1906, s.10.
Parish Property and Documents	Powers to direct as to their custody.	Local Government Act 1972, s.226.
Public buildings and village hall	Power to provide buildings for offices and for public meetings and assemblies.	Local Government Act 1972, s.133. Local Government (Miscellaneous Provisions) Act 1976, s.19.
Public Conveniences	Power to provide.	Public Health Act 1936, s.87.
Recreation	Power to acquire land for or to provide recreation grounds, public walks, pleasure grounds and open spaces and to manage and control them. Power to provide gymnasiums, playing fields, holiday camps. Provision of boating pools.	Public Health Act 1875, s.164. Local Government Act 1972, Sched. 14, para. 27. Public Health Acts Amendment Act 1890, s.44. Open Spaces Act 1906, ss 9 and 10. Local Government (Miscellaneous Provisions) Act 1976, s.19. Public Health Act 1961, s.54.
Seats and Shelters	Power to provide.	Parish Councils Act 1957, ss 2 and 3.
Telecom-munications facilities	Power to pay British Telecommunications or any other public telecommunications operator for loss sustained providing telegraph office or telecommunication facilities.	Telecommunications Act 1984, s.97.
Town and Country Planning	Right to be notified of planning applications.	Town and Country Planning Act 1990, Sched. 1, para. 8.

Function	Powers and Duties	Statutory Provisions
Tourism	Power to contribute to organisations encouraging tourism.	Local Government Act 1972, s.144.
Traffic Calming	Powers to contribute financially to traffic calming schemes.	Highways Act 1980, s.274A.
Transport	Powers to spend money on community transport schemes. Establish and support car sharing. Grant to bus service for elderly and disabled. Grant to support taxi fare concessions. Power to investigate needs and publicise transport services.	Local Government and Rating Act 1997, s.26 s.27 s.28 s.29
War memorials	Power to maintain, repairs, protect and adapt war memorials.	War Memorials (Local Authorities' Powers) Act 1923, s.1; as extended by Local Government Act 1948, s.133.
Water Supply	Power to utilise well, spring or stream and to provide facilities for obtaining water there from.	Public Health Act 1936, s.125.
Well being	Available only to councils meeting certain conditions.	LG and Public Involvement in Health Act 2007, s77.

This list is current at the time of publication (April 2008) but the publishers do not make any representations about it. In addition to the specific powers and duties listed above, local councils have certain general powers (eg s.111 and s.137 LGA1972) and are also subject to duties under various Health and Safety, Employment, Equalities and other legislation. Further information may be obtained from local and regional representatives of NALC and SLCC.

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, which prescribes the way in which auditors are to carry out their functions. The Commission has prepared a Code for the audits of local government bodies and various bodies that provide public services locally. 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 of Schedule 1 to the Act. This statement sets out guidance on general responsibilities relevant to audits and so supports the Code.

2 The purpose of this statement is to assist auditors and audited small bodies (audited bodies) by summarising where – in the context of the usual conduct of an audit – 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 of the body (for example, elected members in local authorities) and its management (the senior officers of the body).

3 The Code recognises the different needs of small bodies. The Commission has to set the threshold for small bodies at £1 million to harmonise the accounting and audit requirements for small bodies with those in the Accounts and Audit Regulations 2003 (as amended). 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 audit role does not include providing financial or legal advice or consultancy to the audited body.

5 Auditors may wish to refer to, and/or incorporate, this statement in audit planning documents, reports and other audit outputs.

Introduction to responsibilities

6 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 proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

7 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. They are also required to report on their arrangements in their annual governance statement.

8 It is the responsibility of the audited body to ensure that proper arrangements are in place, but certain individuals have specific responsibilities. Local authorities have three designated statutory officers each of whom has a specific role in relation to accountability and control. These are:

- the head of paid service, usually the chief executive, responsible to the full council for the corporate and overall strategic management of the authority;
- the monitoring officer who is responsible for reporting to the authority any actual or potential breaches of the law or any maladministration, and for ensuring that procedures for recording and reporting key decisions are operating effectively; and
- an officer with the responsibility for the proper administration of their financial affairs.

9 Small bodies will have a chief executive officer, often known as the Clerk, and a Responsible Financial Officer. The Clerk is the equivalent of the head of paid service and will 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 Financial Officer is the equivalent of the finance officer. In some very small bodies, the role of Clerk and Responsible Financial Officer may be combined, although a separation of these two key roles is always desirable.

10 In carrying out their responsibilities, auditors may wish to obtain representations from management, both orally and in writing, on important matters.

11 The following paragraphs summarise the responsibilities of auditors and of audited bodies in relation to the responsibilities of auditors described in the Code.

Auditing the financial statements

12 The financial statements, which comprise the published accounts of the audited body, are an essential means by which it accounts for its stewardship of the resources at its disposal. These are presented in a summarised format as the statement of accounts in the annual return, as provided by the Audit Commission.

13 It is the responsibility of the audited body to:

- put in place systems of internal control to ensure the regularity and lawfulness of transactions;
- maintain proper accounting records; and
- prepare financial statements that present fairly the financial position of the body and its expenditure and income or properly present its receipts and payments.

14 The audited body is also responsible for preparing and publishing with its financial statements an annual governance statement prepared in accordance with proper practice[9].

15 Auditors audit the annual return, which combines the financial statements and the annual governance statement and give their opinion in the form of a limited assurance statement.

16 Auditors are required by the Audit Commission to:

- review the audited body's compliance with the requirements for the preparation of annual accounts to determine whether it has been prepared properly in accordance with relevant legislation and proper practices;
- carry out a high-level analytical review of financial and other information provided to the auditor;
- review 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; and
- provide an opinion whether, on the basis of these reviews, the accounts of the audited body and the other information provided are in accordance with the Audit Commission's requirements and that no matters have come to the auditor’s attention giving cause for concern that relevant legislative and regulatory requirements have not been met.

17 In carrying out their audit of the financial statements, auditors will have regard to the concept of materiality.

18 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 statements.

19 Auditors may evaluate significant financial systems, and the associated internal financial controls, for the purpose of giving their opinion on the financial statements. 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.

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[9] For local councils, charter trustees and other local government bodies proper practices may be found in 'Governance and Accountability in local councils in England - a Practitioners' Guide 2007 published jointly by NALC and SLCC; for Internal Drainage Boards proper practices may be found in 'Governance and Accountability in Internal Drainage Boards in England - a Practitioners' Guide 2006' which is published by ADA. Other bodies may refer to either of these publications for the source of proper practices as appropriate.

20 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 the statement 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 audit of the financial statements.

21 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.

22 In carrying out their work on the annual return, auditors will:

- plan to complete work and meet 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.

23 Where audited bodies do not meet agreed timetables and/or provide poor documentation such that additional audit work is necessary, or the audit is delayed, auditors will charge additional fees to cover the costs incurred.

Specific powers and duties of auditors

24 Auditors have specific powers and duties under the Audit Commission Act 1998 in relation to matters of legality and electors' rights. 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

25 Auditors provide:

- oral and/or written reports or memoranda to officers and, where appropriate, members on the results of, or matters arising from, specific aspects of auditors' work;
- an audit report including the auditor's opinion on the financial statements and the statement of assurance; and
- a certificate that the audit of the accounts has been completed in accordance with statutory requirements.

26 In addition, the following outputs, the need for which may arise at any point during the audit process, are issued where appropriate:

- 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.

27 When considering the action to be taken on audit reports, audited 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. Audited bodies should assess auditors' conclusions and recommendations for their wider implications before deciding whether to accept or implement them.

28 Although annual audit letters and reports may be addressed to officers or members of the audited body, they are prepared for the sole use of the audited body. Auditors do not have responsibilities to officers or members in their individual capacities (other than in the exercise of auditors' specific powers and duties in relation to matters relating to electors' rights) or to third parties who choose to place reliance upon the reports from auditors.

Ad hoc requests for auditors' views

29 There may be occasions when audited 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 will be 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.

30 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.

Access to information

31 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 voluntary sectors.

32 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. Audited bodies wishing to disclose information obtained from an auditor are required by law to seek the auditor's consent to that disclosure.

Grant claims and returns – certification

33 The Commission agrees to make certification arrangements in accordance with the framework set out in the separate *Statement of Responsibilities of grant-paying bodies, authorities, the Audit Commission and appointed auditors in relation to claims and returns*. The responsibility for ensuring the completion, accuracy and completeness of grant claims and returns lies with the audited body. Grant-paying bodies may require independent examination as a condition of their acceptance of claims and returns and may ask the Commission to make arrangements for auditor certification of claims and returns. The Commission will have regard to what it is appropriate, practically and professionally, to expect the certification process and auditors to do before agreeing to make certification arrangements.

Audit of charitable funds

34 This section is relevant to those charities to which the Audit Commission undertakes an audit under s29 of the Audit Commission Act 1998.

35 Trustees of charitable funds have a duty to prepare financial statements for each financial year which give a true and fair view of:

- the state of the charity's affairs at the end of the financial year; and
- the incoming resources and the application of those resources by the charity for that period.

36 Trustees must ensure that the financial statements are prepared in accordance with the Statement of Recommended Practice – 'Accounting and Reporting by Charities'.

37 It is the duty of the auditor to report to the trustees whether the financial statements give a true and fair view and whether they have been prepared in accordance with the Charities Act 1993 and the Charity (Accounts and Reports) Regulations[10].

38 Auditors are also required to report immediately to the Charity Commissioners any matter which they have reasonable cause to believe is, or is likely to be, of material significance to the Commissioners' functions under s8 (general power to institute inquiries) or s18 (power to act for protection of charities) of the 1993 Act. Such matters may relate not only to the activities or affairs of the charity, but also to any institution or body corporate which is connected with the charity.

[10] All charitable funds with a gross income over £10,000 require independent scrutiny. However for accounting periods commencing after February 2007 the trustees of unincorporated charities with a gross income of £500,000 or less and gross assets of £2.8 million or less may elect for an independent examination of the financial statements. The auditor must then follow the procedures set out in the Charities Acts.

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 £1 million or more (Group A);
- councils with neither annual income or expenditure in excess of £1 million (Group B); and
- councils with neither annual income nor expenditure exceeding £200,000 (Group C).

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

Exhibit 1 Exhibit Local council audit – model of delivery

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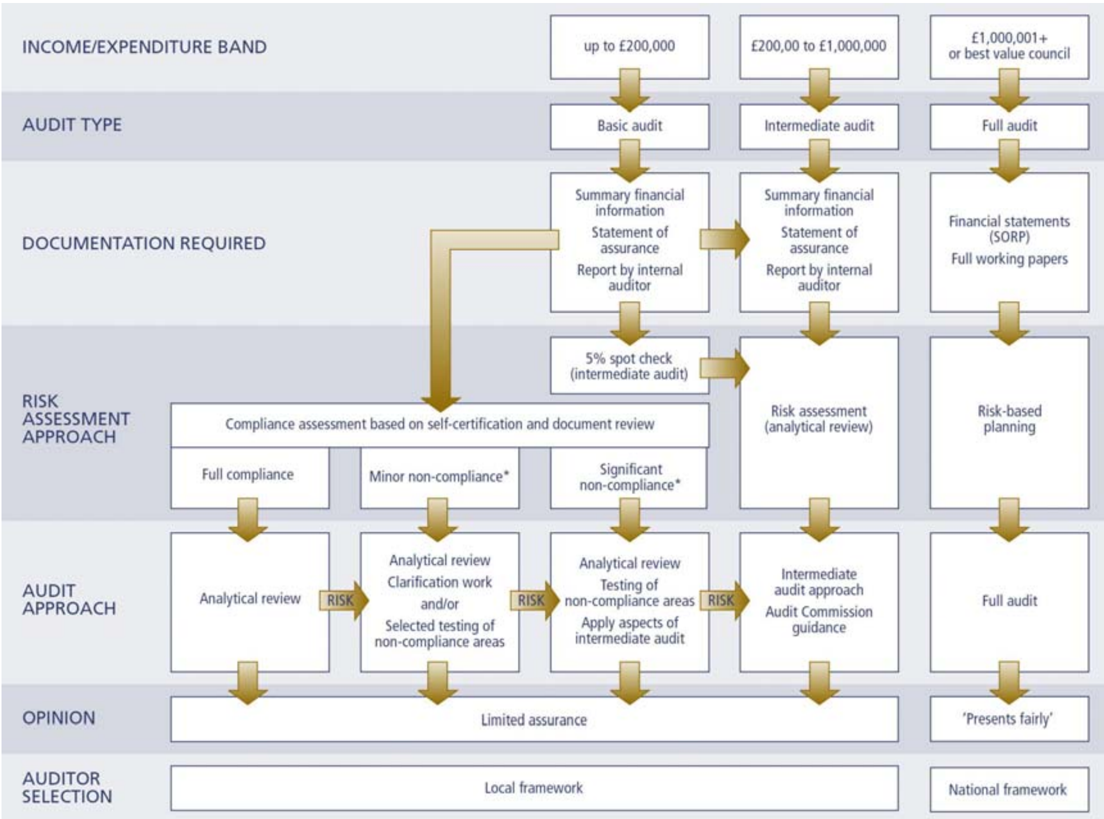

*Non-compliance indicates the presence of unmitigated risk factors which will lead to a more intensive audit as required.

Appendix 4 - Extracts from the Audit Commission's Code of Audit Practice - highlighting amendments relevant to the audit approach for local councils

'Schedule 1: The audit of small bodies'

Introduction

S 1.1. It is inappropriate to apply the same level of audit scrutiny to certain bodies as to principal authorities, because of the relatively small amounts of public money controlled by the bodies in question. This Schedule sets out the approach to be adopted for the audit of small bodies with either annual income, or annual expenditure, of up to a financial level determined, after consultation with relevant bodies, from time to time by the Commission (referred to in this Schedule as small bodies).

Governance and accountability

S 1.2. It is the responsibility of local councils 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.

S 1.3. 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.

The audit approach

S 1.4. Auditors of small bodies should undertake an examination of the annual accounts and additional information and explanation provided by the body.

S 1.5. Auditors should meet their responsibility by:

- reviewing compliance with the requirements for the preparation of the annual 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.

S 1.6. Where, on the basis of the auditor's review, the auditor requires further evidence in relation to any relevant matter, additional testing should be undertaken to address the auditor's concerns.

S 1.7. When the auditor has completed an examination of the annual accounts and additional information and explanation provided, the auditor gives an opinion on the accounts 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

Small Bodies – The Audit Approach

Schedule 1 of the Code

1 Auditors must recognise the fundamental difference between carrying out an audit with a view to giving a 'presents fairly' or 'true and fair' opinion, and carrying out an audit of a small body with a view to giving limited assurance in an opinion based on limited procedures. They should plan their work accordingly, adopting a risk based approach.

2 The Commission works closely with the National Association of Local Councils (NALC) and the Society of Local Council Clerks (SLCC) and their respective County Associations and branches. Similarly, in relation to Internal Drainage Boards, the Commission has developed a technical matters relationship with the Association of Drainage Authorities (ADA). The Commission supports NALC's, SLCC's and the ADA's technical advisory networks. These networks, rather than the external auditors, should be the first point of contact for small bodies with technical accounting queries or questions about the new audit framework. The Commission will provide technical support to the NALC/SLCC network as well as to auditors. In view of this, if asked to provide technical assistance, auditors may wish to remind small bodies and their officers of these arrangements and that auditors are entitled to charge for time taken in resolving enquiries which are outside the audit engagement.

Model of delivery

Overview

3 The model of delivery approved by the Commission is shown in the flowchart at Appendix 2 of *Governance and Accountability in Local Councils in England – A Practitioners' Guide* (2008) published by NALC and SLCC.

4 The key elements of the model are as follows.

- All small bodies in England and Wales are required to complete an annual return (see Appendix 6 of the *Practitioners' Guide* for the pro forma return).
- Some small bodies, such as parish meetings, which have no financial activity may opt for the short-form annual return which serves as a 'nil return' but meets their statutory reporting duty.
- Small bodies with an annual turnover (ie the greater of gross income or gross expenditure) up to £200,000 are entitled to a 'basic' audit.
- Bodies with an annual turnover between £200,001 and £1 million receive an 'intermediate' audit.
- Small bodies with an annual turnover greater than £1 million or which are statutory best value authorities fall outside the scope of these arrangements and will receive a full Code audit ie leading to a 'presents fairly' opinion. Bodies with a regular turnover that is approaching £1 million may wish to opt for a 'full' audit in anticipation of their future transition into this group.
- The limited assurance approach comprises three key elements:
  - a compliance test against the requirements of the annual return;
  - a high level analytical review of the financial and supporting information provided to the auditor; and
  - a review of the statement of assurance.
- These tests and reviews are complemented by a report from the council's appointed internal auditor providing compliance evidence.
- This work leads to the issue, by the external auditor, of a limited assurance opinion on the annual return and a certificate of closure.
- At no extra cost to individual bodies selected, all annual returns will be subject to a 5 per cent selection for more detailed audit – the 'spot check'.
- The model envisages that wherever the auditor is, for any reason, unable to progress directly to giving an opinion on the annual return, based on the information submitted for audit, enquiry and/or further audit work should be targeted at the specific omission, error or risk area. The reasons for additional work should be appropriately documented, and the council informed of the intention to carry out the work and the likely cost implications before commencement. Any further audit testing is designed to deal with the specific issues identified and auditors should ensure that they avoid over-auditing.

5 The Commission has established the overall framework within which auditors will operate but, as with any audit, appointed auditors will need to exercise professional judgement on how best to carry out the work required in support of the limited assurance opinion on the annual return.

6 All audits (regardless of the size of the smaller body) must still be 'called' by the auditor in accordance with statutory requirements. This process ensures that the statutory rights of electors can be exercised. Under this process the auditor appoints a date, on or after which electors' rights may be exercised, by notifying the relevant smaller body. Each appointed auditor will need to make their own administrative arrangements for meeting this requirement, but may wish to use the Commission's AF3 form which is designed for this purpose and distributed to auditors annually by the Commission. Each smaller body is responsible for properly publicising this information. Electors' rights are a sensitive area and so the auditor will wish to be satisfied that the body has provided a positive assurance that they have been properly provided for.

Basic audit

7 The auditor must carry out these procedures for all small bodies falling below the £1 million threshold. Where the body has a turnover of less than £200,000 per annum, and is not selected to be part of the 5 per cent quality assurance sample, then these procedures will – if properly applied – enable the completion of the limited assurance audit. Where the council has a greater turnover, or is part of the quality assurance sample, the 'intermediate audit' procedures described below will also have to be followed.

8 The council will complete and submit the annual return pro forma. Three sections should be completed as follows.

- *Section 1:* Statement of accounts – the body should have transferred key financial data items from their prime accounting records in accordance with the guidance provided on the pro forma.
- *Section 2*: Statement of assurance – this should be completed by the members of the body summarising their acceptance and understanding of their statutory responsibilities and providing an acknowledgement that they have fulfilled the duties imposed by statute (as per the pro forma).
- *Section 4*: Annual report by internal audit – this should contain a report on the adequacy and effectiveness of the body's system of internal controls as per the pro forma.

9 Guidance in the annual return pro forma reminds bodies to attach certain other documentation. This will be the minimum required and failure to provide this will trigger additional audit input, which may be charged to the smaller body. The further information to be submitted to the external auditor with the annual return is:

- year-end bank reconciliation. An example of the suggested format is given in the Practitioners' Guides. Copies of bank statement pages covering the 31 March financial year end may also be attached; and
- brief explanation(s) of significant variances between and within years in the annual return.

10 Auditors may also wish to obtain certain optional additional information, as follows.

- If audit procedures (analytical review, risk assessment, cumulative audit knowledge etc), or the body's unresolved omission or error on the annual return, or some other justifiable reason, indicate possible irregularity, the auditor may, having informed the body of his/her intention, request an independent verification of bank and/or investment balances in order to carry out required further work. But auditors should note that there is a cost implication for small bodies in making such a request. Banks may charge up to £50 for this service.
- The Commission will annually circulate to auditors year-end balances of borrowings by small bodies from the Public Works Loan Board ('PWLB').
- Auditors should make their own arrangements with Council Tax managers of principal authorities in their contract/ appointment area (or their auditors) to receive client local council precept data for the relevant financial year.

11 When the relevant information is obtained, the next step is the completion of the audit. There are two elements to this process:

- in cases where a properly completed annual return is submitted and the high level analytical review indicates no unresolved material audit risk, the auditor should proceed to sign the certificate and opinion at section 3 of the return**;** or
- if additional audit work is indicated from the initial examination of the annual return, auditors should identify the specific area of concern and the additional work required, which should be limited to dealing with the specific area of concern, make an estimate of the time required to carry out this work and inform the audited body before commencing the work. The justification for the decision to carry out any additional work must be properly evidenced.

Intermediate audit (bodies with turnover between £200,000 and £1 million)

12 In addition to the requirements of the basic audit above, auditors should plan and carry out work in order to complete the Commission's intermediate audit guidance. This focuses on the body's overall control environment and helps the auditor to plan any further work indicated by the results. The guidance is set out below.

13 The intermediate audit is the process whereby auditors obtain additional audit evidence in support of their opinion to reflect the additional audit risk associated with higher levels of activity or expenditure at larger small bodies, as defined below, or in support of the 5 per cent spot check of basic audits.

14 In addition to the basic audit, auditors may wish to apply general and specific audit tests designed to give them greater assurance about the audited body's risk management and corporate governance arrangements than can be provided by the annual return alone. It is applicable to all small bodies where either their annual expenditure or annual income exceeds £200,000 but is below £1 million. It is also applicable to an annual sample of 5 per cent of small bodies with a turnover of under £200,000 per annum. This sample is used to establish the ongoing efficacy of the basic audit approach.

15 The intermediate audit seeks to test one or more of the assertions made by the audited body and thereby provide additional audit evidence through a 'show me' approach to the responses given in the statement of assurance. The auditor will consider the following factors in order to determine the frequency and extent to which they wish to apply some or all of the suggested tests:

- the initial risk assessment; and
- cumulative audit knowledge and experience.

16 In addition, the auditor may also consider the following factors, when information is received from the smaller body:

- the outcome of the analytical review of information supplied; and
- the level of compliance with requirements.

17 The auditor will only consider making a further document request if the necessary information cannot be obtained from the documents already obtained from the smaller body.

18 The Commission expects the evidence required by auditors for intermediate audit to be proportionate to the audit risk. Any additional work arising from intermediate audit must be evidenced and documented as appropriate.

19 Each of the eight assertions in the statement of assurance (section 2 of the annual return) is reproduced below, together with some suggested tests that may be applied, either in the form of an additional questionnaire to the smaller body or by using other audit methods.

20 In order to reduce the frequency of correspondence and to provide a reasonable time for response, the Commission recommends that in practice, auditors should, wherever possible, advise the audited body when calling the audit about the additional evidence being sought under intermediate audit. A provision for this has been made in the AF3.

21 The cost of intermediate audit, whether determined by the turnover of the smaller body or required for the 5 per cent sample of smaller bodies, is included in the scale fees.

22 Auditors should note when planning the intermediate audit that the format of the audit opinion is the same limited assurance opinion that applies to basic audit.

Other matters - previous years' audits not completed

23 In cases where the previous years' audits have not been completed/closed, auditors should include the following text in their report on the return: 'The audit of the [*smaller body*]'s accounts for the years ended 31 March 20XX and 20YY have yet to be concluded and as a consequence the audit for the year ended 31 March 20ZZ must remain open. While the audit report given above is in advance of the conclusion of the audit, we can confirm that our opinion is subject only to the changes that may be required to balances brought forward as shown in section 1 as a consequence of the conclusion of prior years' audits.'

Other matters - audits not completed at statutory deadline

24 In the event that an audit has not been concluded and no audit opinion has been issued prior to the statutory deadline, the Accounts and Audit Regulations stipulate that the smaller body should publish its statement of accounts together with a declaration and explanation of the fact that no audit opinion has been issued by the statutory publication date. Auditors should provide to bodies a 'confirmation' letter suitable for public display confirming that as 'at the statutory publication date no audit opinion has yet been issued in relation to the statement of accounts for the year ended 31 March 20XX.'

25 A covering letter provided to the smaller body should set out the requirements of regulation 12 of the Accounts and Audit Regulations 2003 and should indicate that the smaller body can meet its statutory obligations by displaying a copy of the Annual Return marked 'subject to audit' at the top of section 1 of the Annual Return and by displaying a copy of the 'confirmation' letter, confirming that the audit opinion has not been issued. The covering letter may also indicate that the requirement to publish can be achieved by display of the items on the same notice board(s) or publication which was used for the notice of audit although publication in a newspaper is not required unless that is the smaller body's usual or preferred method of advertising the audit.

Statement of Assurance	Possible further assurance request	Possible additional documentation request
'We have approved the accounts which have been prepared in accordance with the requirements of the Accounts and Audit Regulations and proper practices.'	Does the smaller body have access to a Practitioners' Guide on proper practices and have the accounts been prepared in accordance with this guidance? Has the body properly prepared its financial summary? Did the body/committee review the bank reconciliation?	Copy of financial statements 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.'	Confirm that arrangements in place to ensure system of internal control are fully documented. Confirm that the body receives regular reports regarding internal controls/fraud protection.	Copy of internal auditor's reports re internal controls. Copy of minute(s) where internal controls discussed/approved.
'We have taken 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 smaller body to conduct its business or on its finances.'	Confirmation that all expenditure decisions made are within existing powers and minuted. Confirm body has adopted Standing Orders and Financial Regulations. Confirm smaller body has adopted and applies the Code of Conduct, if applicable. Confirm all members have received training on the Code of Conduct, if applicable.	Copies of minutes for a selected period showing expenditure powers have been properly identified. Copy of Standing Orders/Financial Regulations and/or minute adopting. Copy of minute adopting Code of Conduct. Extract from declarations of interest. Sample copies of members' acceptance of office.

Statement of Assurance	Possible further assurance request	Possible additional documentation request
'We have provided proper opportunity 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. Copy of arrangements in place for inspection of accounts.
'We have carried out an assessment of the risks facing the smaller 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 smaller body. Confirm that appropriate insurance cover for identified risks is in place. Confirm smaller body regularly seeks assurance regarding internal controls.	Copy of risk management minute. Copy of insurance schedule including value of Fidelity Guarantee bond. Copy of any risk assessment reports (if any).
'We have maintained an adequate and effective system of internal audit of the smaller body's accounting records and control systems.'	Confirm that internal audit is carried out in accordance with proper practice guidance in the Practitioners' Guide. Confirm that internal audit is not requested to undertake tasks or give advice which may compromise or fetter his/her independence or invalidate the smaller body's insurance.	Copy of minute appointing/reappointing internal audit. Copy of letter of engagement scoping IA work. Copy of annual letter from IA confirming continuing independence.

Statement of Assurance	**Possible further assurance request**	**Possible additional documentation request**
'We have taken what we consider to be appropriate action on all matters raised in previous reports from the internal and external auditors.'	Confirm that all internal and external audit reports have been placed before and considered by the smaller body. Confirm that there are no outstanding matters from previous audit reports.	Copy of minute recording auditors' report. Copy of agreed action plans to carry out recommendations.
'We are not aware of any litigation, liabilities or commitments, events or transactions, occurring either during or after the end of the financial year being reported, other than those included in the accounts.'	Confirm that reserves are adequate and not excessive. Confirm that where there are any claims against the smaller body, any uninsured portion has been provided for. Confirm smaller body has not borrowed any money other than for financing capital schemes. Confirm no changes to existing capital programmes.	Copy of analysis of reserves identifying general fund and any earmarked reserves. Details of any provisions made or added to in the year. Copy of capital expenditure programme. Details of any loans outstanding or applied for. Details of any current or planned lottery bids.

Appendix 6 - Annual return for local councils for the year ending 31 March 2008

Local Councils in England
Annual return for the year ended 31 March 2008

Local councils in England (Parish Meetings, Parish and Town Councils) with an annual turnover of £1 million or less must complete an annual return summarising their annual activities at the end of each financial year.

The annual return on the following pages is made up of four sections:

– **Sections 1 and 2** are to be completed by the person nominated by the council.
– **Section 3** will be completed by the external auditor.
– **Section 4** is to be completed by the council's internal audit provider.

The council must ensure this annual return is approved no later than 31 July 2008.

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

Please send the annual return, together with any additional information requested, to your appointed external auditor.

If required, your auditor will identify and ask for any documents needed for audit. Unless requested, please do **not** send any original financial records to the external auditor.

Audited and certified annual returns will be returned to the council for publication or public display of sections 1,2 and 3.

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

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

Section 1 – Statement of accounts

ENTER NAME HERE COUNCIL/MEETING

In completing the boxes below please explain any significant variances on a separate sheet and send this to the external auditor together with a copy of your bank reconciliation as at 31 March 2008.

	Year ending		Notes and guidance
	31 March 2007 £	31 March 2008 £	**Please round all figures to nearest £. Do not leave any boxes blank and report £0 or Nil balances. All figures must agree to the council's underlying financial records.**
1 Balances brought forward			Total balances and reserves at the beginning of the year as recorded in the council's financial records. Value must agree to Box 7 of previous year.
2 (+) Annual precept			Total amount of precept received in the year.
3 (+) Total other receipts			Total receipts or income as recorded in the cashbook less the precept. Includes support, discretionary and revenue grants.
4 (-) Staff costs			Total expenditure or payments made to and on behalf of all council employees. Include salaries and wages, PAYE and NI (employees and employers), pension contributions and related 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 (-) Total 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 and long term assets			The recorded book value at 31 March of all fixed assets owned by the council and any other long term assets e.g. loans to third parties.
10 Total borrowings			The outstanding capital balance as at 31 March of all loans from third parties (including PWLB).
11 Trust funds disclosure note	YES/NO	YES/NO	**The council acts as sole trustee for and is responsible for managing [a] trust fund[s]/assets. (Readers should note that the figures above do not include any trust transactions.)**

I certify that the statement of accounts contained in this annual return presents fairly the financial position of the council and its income and expenditure, or properly presents receipts and payments, as the case may be, for the year ended 31 March 2008.

Signed by Responsible Financial Officer

SIGNATURE REQUIRED

Date DD/MM/YYYY

I confirm that these accounts were approved by the council and recorded as council minute reference COUNCIL MINUTE REFERENCE

Date DD/MM/YYYY

Signed by Chair of meeting approving council's accounts

SIGNATURE REQUIRED

Date DD/MM/YYYY

Section 2 – Annual governance statement

We acknowledge as the members of ENTER NAME HERE COUNCIL/MEETING our responsibility for ensuring that there is a sound system of internal control, including the preparation of the statement of accounts. We confirm, to the best of our knowledge and belief, with respect to the council's statement of accounts for the year ended 31 March 2008, that:

		Agreed – Yes or No*	'Yes' means that the council:
1	we have approved the statement of accounts which has been prepared in accordance with the requirements of the Accounts and Audit Regulations and proper practices.		prepared its statement of accounts in the way prescribed by law.
2	we have maintained an adequate system of internal control, including measures designed to prevent and detect fraud and corruption **and** reviewed its effectiveness.		made proper arrangements and accepted responsibility for safeguarding the public money and resources in its charge.
3	we have taken all reasonable steps to assure ourselves that there are no matters of actual or potential non-compliance with laws, regulations and codes of practice which could have a significant financial effect on the ability of the council to conduct its business or on its finances.		has only done things that it has the legal power to do and has conformed to codes of practice and standards in the way it has done so.
4	we have provided proper opportunity during the year for the exercise of electors' rights in accordance with the requirements of the Accounts and Audit Regulations.		has during the year given all persons interested the opportunity to inspect and ask questions about the council's accounts.
5	we have carried out an assessment of the risks facing the council **and** taken appropriate steps to manage those risks, including the introduction of internal controls and/or external insurance cover where required.		considered the financial and other risks it faces and has dealt with them properly.
6	we have maintained throughout the year an adequate and effective system of internal audit of the council's accounting records and control systems **and** carried out a review of its effectiveness.		arranged for a competent person, independent of the financial controls and procedures, to give an objective view on whether these meet the needs of the council and reviewed the impact of this work.
7	we have taken appropriate action on all matters raised in reports from internal and external audit.		has responded to matters brought to its attention by internal and external audit.
8	we have considered whether any litigation, liabilities or commitments, events or transactions, occurring either during or after the year-end, have a financial impact on the council **and**, where appropriate have included them in the statement of accounts.		disclosed everything it should have about its business during the year including events taking place after the year-end if relevant.
9	Trust funds – in our capacity as the 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.	YES, NO or N/A	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 council minute reference COUNCIL MINUTE REFERENCE dated DD/MM/YYYY

Signed on behalf of ENTER NAME HERE COUNCIL/MEETING

Signed by: Chair SIGNATURE REQUIRED Date DD/MM/YYYY

Signed by: Clerk SIGNATURE REQUIRED Date DD/MM/YYYY

***Note:** Please provide explanations to the external auditor on a **separate sheet** for each 'No' response that has been given; and describe what action is being taken to address the weaknesses identified.

Section 3 – External auditor's certificate and opinion

Certificate

We certify that we have completed the audit of the annual return for the year ended 31 March 2008 of

COUNCIL/MEETING

Respective responsibilities of the council and the auditor

The council is responsible for the preparation of the accounts in accordance with the requirements of the Accounts and Audit Regulations and for the preparation of an annual return which:

- summarises the council's accounting records for the year ended 31 March 2008; 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's report

(Except for the matters reported below)* on the basis of our review, in our opinion the information contained in the annual return is in accordance with the Audit Commission's requirements 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/meeting:

(continue on a separate sheet if required)

External auditor's signature

External auditor's 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 to

ENTER NAME HERE 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 2008.

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, opposite, are the internal audit conclusions on whether, in all significant respects, the following control objectives were being achieved throughout the financial year to a standard adequate to meet the needs of the council.

		Agreed? Please choose from one of the following Yes/No*/Not covered**
A	Appropriate books of account have been properly kept throughout the year.	
B	The council's financial regulations have been met, payments were supported by invoices, 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, 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	Year-end accounts were prepared on the correct accounting basis (receipts and payments/income and expenditure), agreed with cash book, were supported by an adequate audit trail from underlying records, and, where appropriate debtors and creditors were properly recorded.	
K	**The council has met its responsibilities as a trustee.**	

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 PRINT NAME

Signature of person who carried out the internal audit SIGNATURE REQUIRED Date DD/MM/YYYY

***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 2008 annual return

1 Please 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 approved by the council, properly initialled and an explanation for them is provided to the auditor. Annual returns containing unapproved and/or unexplained amendments will be returned unaudited.

2 Use the checklist provided below. Use a second pair of eyes, perhaps internal audit or the Chair, to review your annual return for completeness before sending it off to the auditor.

3 Please do not send the auditor any information that you are not specifically asked for. Doing so is not helpful.

4 Make sure that the copy of the bank reconciliation which you send to your auditor with the annual return covers **all** your bank accounts. If your council holds any investments, please note their value on the bank reconciliation. The auditor should be able to agree your bank reconciliation to Box 8 on the Statement of Accounts. **You must provide an explanation for any difference between Box 7 and Box 8.** More help on bank reconciliations is available in the *Practitioners' Guide**.

5 Please **explain fully** significant variances in the statement of accounts. Do not just send in a copy of your detailed accounts instead of this explanation. The auditor wants to know that **you** understand the reasons for the change. Please include a complete analysis to support your explanation. There are a number of examples provided in the *Practitioners' Guide** to assist you.

6 If the 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.

7 Please make sure that your statement of accounts adds up! Also please ensure that the balance carried forward from the previous year (Box 7 of 2007) equals the balance brought forward in the current year (Box 1 of 2008).

8 **Do not complete section 3.** This section is reserved for the external auditor who will complete it at the conclusion of their audit.

9 Use the *Practitioners' Guide** for guidance. This publication is regularly updated and contains everything you should need to prepare successfully for your financial year-end and the subsequent audit. Both NALC and SLCC have helplines open should you wish to talk through any problem you may encounter.

Completion checklist – 'No' answers mean you may not have met requirements		Done?
All sections	All green boxes have been completed?	YES/NO
	All information requested by the external auditor has been sent with this annual return? Please refer to your notice of audit.	YES/NO
Section 1	Council approval confirmed by signature of Chair of meeting approving accounts?	YES/NO
	An explanation of significant variations from last year to this year is provided?	YES/NO
	Bank reconciliation as at 31 March 2008 agreed to Box 8?	YES/NO
	An explanation of any difference between Box 7 and Box 8 is provided?	YES/NO
Sections 1 and 2	Trust funds – all disclosures made if council is a sole managing trustee? **NB: Do not send trust accounts unless requested.**	YES/NO
Section 2	For any statement to which the response is 'no', an explanation is provided?	YES/NO
Section 4	All green boxes completed by internal audit and explanations provided?	YES/NO

***Note:** *Governance and Accountability for Local Councils in England – A Practitioners' Guide 2008 edition*, is available from your local NALC and SLCC representatives.

Appendix 7 - Accounts and Audit Regulations and Guidance

Accounts and Audit Regulations 2003 – SI 2003 No 533 as amended by The Accounts and Audit (Amendment) (England) Regulations 2006 SI 2006 No 564

http://www.audit-commission.gov.uk/practitionersguide

CLG Guidance Circular 03/2006

http://www.audit-commission.gov.uk/practitionersguide

Appendix 8 - Local Government Investments - CLG guidance

OFFICE OF THE
DEPUTY PRIME MINISTER

Trevor Emmott
Capital Finance Policy
LGF4B
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Bressenden Place
London SW1E 5DU

Direct line: 020 7944 4234
Fax: 020 7944 4239

trevor.emmott@odpm.gsi.gov.uk

Web site: www.odpm.gov.uk

12 March 2004

Chief Executives
Directors of Finance

Local authorities in England

Dear Colleague

LOCAL GOVERNMENT INVESTMENTS
GUIDANCE UNDER SECTION 15(1)(a) OF THE LOCAL GOVERNMENT ACT 2003

With my letter of 15 December 2003, I circulated for consultation draft guidance on local government investments. The consultation ended on 30 January and we are most grateful to all the authorities and other bodies who responded. We have considered the comments in liaison with the Local Government Association, the Audit Commission and CIPFA.

The guidance is now formally issued by the Secretary of State under section 15(1)(a) of the *Local Government Act 2003*. I enclose a copy of the guidance, together with an informal commentary and background information.

The guidance applies in relation to the financial year 2004-05 and subsequent financial years. However, authorities are required to have regard to it immediately, since action is needed now. Normally, an Annual Investment Strategy should be approved by the full Council before the start of the financial year (paragraph 11 of the guidance). If it is impracticable for the Council to meet before 1 April this year, approval may, on this occasion only, be obtained as soon as possible after the start of the financial year.

Authorities who have prepared their Strategies on the basis of the draft guidance are unlikely to need to revise them, since the content has not changed substantially. The main outcome of the consultation is outlined in paragraph 9 of the commentary, which explains that regulations have been made to ensure that certain investments (in *money market funds* and *multilateral development banks*) will not count as capital expenditure.

The present investments rules, in the *Local Authorities (Capital Finance) (Approved Investments) Regulations 1990*, made under Part 4 of the *Local Government and Housing Act 1989*, will of course cease to have effect when Part 4 is repealed on 1 April 2004.

Any enquiries about the guidance should be addressed to my colleague Ross Buchanan here at: ross.buchanan@odpm.gsi.gov.uk

Yours sincerely

Trevor Emmott

GUIDANCE ON
LOCAL GOVERNMENT INVESTMENTS

Office of the Deputy Prime Minister

Contents

Part 1 of this document gives informal advice only and is not part of the guidance itself, which is contained in Part 2.

PART 1 - BACKGROUND AND COMMENTARY

(1) INVESTMENT POLICY

1. Since 1990, local government investments have been subject to the *Local Authorities (Capital Finance) (Approved Investments) Regulations 1990 [SI 1990/426 as amended]*, made under Part 4 of the *Local Government and Housing Act 1989* ("the 1989 Act").

2. The repeal of Part 4 on 1 April 2004 by the *Local Government Act 2003* ("the 2003 Act") and the parallel revocation of the "approved investments" regulations brings this regime to an end, as part of the introduction of the new prudential capital finance system. Under the new system, the Government still wishes to encourage authorities to invest prudently, but without burdening authorities with the detailed prescriptive regulation characteristic of the 1989 Act system. The issue of guidance under section 15 of the 2003 Act implements that policy.

(2) INVESTMENT POWER

3. **Section 12** of the 2003 Act removes the doubts which persisted under the 1989 Act regime and gives a local authority power to invest for "any purpose relevant to its functions under any enactment, or for the purposes of the prudent management of its financial affairs". The reference to the "prudent management of its financial affairs" is included to cover investments which are not directly linked to identifiable statutory functions but are simply made in the course of treasury management. This would also allow the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future; however, the speculative procedure of borrowing purely in order to invest remains unlawful.

(3) INVESTMENT GUIDANCE BY CIPFA

4. **Section 15(1)** of the 2003 Act requires an authority "…to have regard (a) to such guidance as the Secretary of State may issue, and (b) to such other guidance as the Secretary of State may by regulations specify…".

5. The *Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146]* (made under the *Local Government Act 2003*) contain a regulation [regulation 24] relying on the power in section 15(1)(b). It requires authorities to have regard to the

Chartered Institute of Public Finance and Accountancy (CIPFA) publication ***Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes***. This Code covers the whole range of treasury management issues, including the fundamental principles for making and managing investments. It should be noted that the Code prepared by CIPFA for the new capital finance system, ***The Prudential Code for Capital Finance in Local Authorities***, also includes guidance on treasury management.

6. The guidance in Part 2 of this document is issued under the power in section 15(1)(a). This does not duplicate the material covered in the CIPFA Codes but builds upon it and supplements it as necessary to implement the Government's policy. A detailed commentary on the guidance is given below (paragraphs 12 to 25).

(4) INVESTMENT REGULATIONS

7. The *Local Authorities (Capital Finance and Accounting) (England) Regulations 2003*, which come into force on 1 April 2004, include provisions relevant to investments.

8. Regulation 25(1)(d), made under section 16(2) of the 2003 Act, defines as capital expenditure the acquisition of **share capital or loan capital** in any body corporate. This continues the effect of the provision in section 40(4)(b) of the 1989 Act. Such investments will therefore need to be funded out of capital or revenue resources (as well as being subject to the guidance on "non-specified investments"). The intention here is to discourage the use of speculative investments, such as equities.

9. In the consultation on this guidance, representations were made to ODPM that the definition in regulation 25(1)(d) would apply to investments in *money market funds* (as defined in regulation 1 of the *Approved Investments Regulations* 1990). Accordingly, amendments have now been made in the *Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2004 [SI No. 534]*, which also come into force on 1 April 2004, to exclude such investments from the definition of capital expenditure. Similar concern was expressed in relation to bonds issued by the kinds of bodies listed in Part 1 of the Schedule to the 1990 regulations. Again, this is dealt with in the amending regulations, which exclude from the definition of capital expenditure investments with a *multilateral development bank* (defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world). These amendments to regulation 25(1)(d) are relevant to the interpretation of paragraph 12(c) in the guidance. The effect is that investments in money market funds or with multilateral development banks are *not* capital expenditure and may be "specified investments" (subject to the other conditions in paragraph 12 of the guidance also being met).

10. Investments not defined as capital expenditure by regulation 25(1)(d) will not score as expenditure at all and will not be charged to revenue or capital. However, if any existing investment ever appeared at risk of loss, normal accounting practice would as now require the authority at that time to make revenue provision of an appropriate amount.

11. It should also be noted that regulation 25(1)(b) defines as capital expenditure a **loan** (or grant or other financial assistance) by an authority to another body for capital expenditure by that body.

(5) INFORMAL COMMENTARY ON THE ODPM GUIDANCE

12. Under the power in section 15(1)(a) in the 2003 Act, the Secretary of State has issued the guidance on investments in Part 2 of this document. Local authorities are required by section 15 of the 2003 Act to have regard to this guidance. It may also apply to parishes (see paragraph 25). The guidance applies only in England.

13. The guidance does not apply to pension and trust funds which are covered by a completely separate regulatory regime.

14. The general policy objective is that local authorities should invest **prudently** the surplus funds held on behalf of their communities.

15. The guidance recommends that priority should be given to security and liquidity. However, that does not mean that authorities should ignore yield. It will be appropriate to seek the highest rate of return consistent with the proper levels of security and liquidity.

Annual Investment Strategy

16. The Annual Investment Strategy is central to the guidance. As noted above, authorities will also need to have regard to the CIPFA Treasury Management Code, which requires the preparation of an annual treasury management strategy and plan in advance of the year and an annual report after the year end. There is no intention to require authorities to duplicate any of the tasks specified in the CIPFA Code. It may be convenient to produce a single strategy document, covering both the requirements of the CIPFA code and the Secretary of State's guidance. However, the document should state explicitly where it is dealing with the guidance by the Secretary of State.

17. The Secretary of State recommends (paragraphs 7 to 9 of the guidance) that the Strategy should be approved by the full Council (or at equivalent level in authorities without a Council). The *Local Authorities (Functions and Responsibilities) (England) Regulations 2000 (S.I. 2000/2853, as amended)* empower a Council to determine that it should be responsible for such matters as approving the Strategy and that is what the guidance recommends. It is intended that an amendment will shortly be made to the regulations specifying that the function of approving such strategies is always for the full Council.

18. Normally, the Strategy should be approved before the start of the financial year. Because this guidance is being issued shortly before the start of 2004/05, it may not be feasible to have the Strategy for that year endorsed by the Council before 1 April 2004. In that case, approval should be obtained as soon as possible after that date.

19. The Strategy may be varied at any time during the year, again with the approval of the full Council. It should be possible to incorporate in the Strategy sufficient flexibilities and delegations to avoid the need for a formal variation, other than in the most exceptional circumstances. Where external investment managers are used, they should be contractually required to comply with the Strategy.

Specified Investments

20. The idea of specified investments is to identify investments offering high security and high liquidity. Authorities will be free to rely on these with minimal procedural formalities. All such investments should be in sterling and with a maturity of no more than a year. Such short-term investments made with the UK Government or a local authority or parish council will automatically count as specified investments.

21. In addition, short-term sterling investments with bodies or investment schemes with "high credit ratings" will count as specified investments. However, the Annual Investment Strategy should define this term for broad categories of investment. The Strategy should also say how frequently ratings are to be monitored and what is to happen if they change.

Non-specified Investments

22. The Annual Investment Strategy should deal in more detail with non-specified investments, given the greater potential risk. It should identify the types of investments that may be used during the course of the year and should set a limit to the amounts that may be held in such investments at any time in the year. The limit may be a sum of money or a percentage of total investments. The Strategy should also lay down guidelines for making decisions on such investments, for example, on the circumstances in which professional advice is to be sought.

23. There is no intention of discouraging authorities from using non-specified investments. The aim is simply to ensure that proper procedures are in place for undertaking risk assessments of investments made for longer periods or with bodies which are not highly credit-rated. It is not implied that credit ratings are the only means of assessing creditworthiness; but where an alternative or additional method is considered appropriate, it should be summarised and explained in the Strategy.

Liquidity of investments

24. The Annual Investment Strategy should set out procedures for determining the maximum periods for which funds may prudently be committed. This is to ensure that the authority has properly assessed the risk of committing funds to longer term investments. An investment should be regarded as commencing on the date the commitment to invest is entered into, rather than the date on which the funds are paid over to the counterparty.

Application to Parish Councils

25. The guidance will in certain cases apply to parish councils (and charter trustees), depending upon the level of investments they expect to have in a particular financial year. If that level is expected to exceed £500,000 during the year, the guidance should be treated as applying in full in relation to the whole year. Where investments are expected to exceed £10,000 but not £500,000, the council should simply make a formal decision on the extent to which it would be reasonable to adopt this guidance, either wholly or in part. For councils not expecting their investments to exceed £10,000, no action is necessary. However, such councils will of course be free to adopt the guidance if they wish.

[PART 2]

GUIDANCE ON LOCAL GOVERNMENT INVESTMENTS

Issued by the Secretary of State under section 15(1)(a) of the Local Government Act 2003

DEFINITIONS

1. In this guidance, ***2003 Act*** means the *Local Government Act 2003*

2. ***Local authority*** (except in paragraph 12(d) below) has the meaning given in section 23 of the 2003 Act (and in regulations made under that section). To the extent that this guidance applies to parish councils and charter trustees (see paragraph 6 below), a reference to a "local authority" includes those councils and trustees.

3. An ***investment*** is a transaction which relies upon the power in section 12 of the 2003 Act and is recorded in the balance sheet under the heading of investments within current assets or long-term investments. The term does not include *pension fund and trust fund investments*, which are subject to separate regulatory regimes and are therefore not covered by this guidance.

4. A ***long-term investment*** is any investment other than (a) one which is due to be repaid within 12 months of the date on which the investment was made or (b) one which the local authority may require to be repaid within that period.

5. A ***credit rating agency*** is one of the following three companies: *Standard and Poor's; Moody's Investors Service Ltd; Fitch Ratings Ltd.*

APPLICATION

6. This guidance applies in relation to the financial year 2004-05 and subsequent financial years. It applies only in England. It applies to all local authorities. It also applies to parish councils and charter trustees, subject to the following conditions:

(a) Where the parish council or charter trustee expects its investments at any time during a financial year to exceed £500,000, the guidance should apply in relation to that year.

(b) Where the parish council or charter trustee expects its investments at any time during a financial year to exceed £10,000 but not £500,000, it should decide on the extent, if any, to which it would be reasonable to have regard to the guidance in relation to that year.

(c) Where the parish council or charter trustee expects its investments at any time during a financial year not to exceed £10,000, no part of this guidance need be treated as applying in relation to that year.

ANNUAL INVESTMENT STRATEGY

7. The Secretary of State recommends that a local authority produces an **Annual Investment Strategy**, approved by the full council, that sets out the local authority's policies for managing its investments and for giving priority to the security and liquidity of those investments, as indicated in this guidance.

8. The Secretary of State considers that where the local authority is operating executive arrangements, it would be preferable for the local authority (ie the full council), rather than its executive, to approve the Strategy. Under Schedule 4 to the *Local Authorities (Functions and Responsibilities) (England) Regulations 2000 (S.I. 2000/2853, as amended)*, the authority has discretion to determine that the decision should be taken by them on whether the Strategy should be approved. The Secretary of State therefore recommends that they make such a determination.

9. For authorities without a full council, approval of the Strategy should be at the closest equivalent level.

10. Variations to the Strategy may be made at any time, subject to the same process of approval.

11. The Secretary of State recommends that the Strategy for any financial year should normally be approved before the start of that year. For the year 2004-05 only, it should be approved either before the start of the year or as soon as possible after the start. The Strategy and any variations should be made available to the public.

SECURITY OF INVESTMENTS

Specified Investments

12. An investment is a ***specified investment*** if:

(a) the investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling;

(b) the investment is not a long-term investment (as defined in paragraph 4);

(c) the making of the investment is not defined as capital expenditure by virtue of regulation 25(1)(d) of the *Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146 as amended]*; and

(d) the investment is made with a body or in an investment scheme which has been awarded a high credit rating (see paragraph 13) by a credit rating agency (as defined in paragraph 5) or is made with any of the following:
   (i) the United Kingdom Government
   (ii) a local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland
   (iii) a parish council or community council.

13. For the purposes of paragraph 12(d) above, the Secretary of State recommends that the **Annual Investment Strategy** states:

(a) how ***high credit rating*** is to be defined for the categories of investments which the local authority intends to use in the financial year

(b) how and how frequently credit ratings are to be monitored and what action is to be taken when ratings change.

Non-specified Investments

14. With regard to non-specified investments (ie those not meeting the definition in paragraph 12), the Secretary of State recommends that the **Annual Investment Strategy**:

(a) sets out procedures for determining which categories of such investments may prudently be used;

(b) identifies which categories of such investments have so far been identified as prudent for use during the financial year; and

(c) states the upper limits for the amounts which, at any time during the financial year, may be held in each identified category and for the overall amount which may be held in non-specified investments (the limits being defined by reference to a sum of money or a percentage of the local authority's overall investments).

LIQUIDITY OF INVESTMENTS

15. The Secretary of State recommends that the **Annual Investment Strategy** sets out procedures for determining the maximum periods for which funds may prudently be committed.

Office of the Deputy Prime Minister ***12 March 2004***

Eland House Bressenden Place London SW1E 5DU

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 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 financial 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?

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 - An executive checklist for financial year-ends

This checklist is provided for use by the Chair as a final check for completeness of the council's annual accounting and reporting cycle.

Answering 'Yes' to the questions below should provide assurance that the necessary steps have been taken during the year and that the process is now complete and may be signed off.

Any 'no' answers indicate that further work may need to be carried out.

References to relevant sections of the Practitioners' Guide are included.

Governance		**YES**	**NO**
1	During the year, has the council reviewed its system of **internal control**, including internal audit, risk management and measures designed to prevent fraud and corruption, and assessed it as adequate and effective? *(See Practitioners Guide (PG) paragraph 2.79)*		
2	Has the council only done what it has the **legal powers** to do and in doing so acted in accordance with the codes of conduct and practice it has agreed to abide by? (*PG Appendix 1)*		
3	Has the council appointed a **responsible financial officer** who has ensured that the council's accounting system has been observed and that the accounts and supporting records have been maintained in accordance with proper practices and kept up to date? (*PG 1.24)*		
4	Has the council arranged for **internal audit** to be carried out and reported upon? (*PG 2.58)*		
5	Has the council reviewed its income and spending against the approved budget during the year **and** as at 31 March? (*PG 2.15, 3.29 to 3.33)*		
The accounts			
6	Has the cashbook been balanced? (Bank balance at end of previous year plus total receipts less total payments equals bank balance at end of current year after adjusting for unpresented cheques and credits). (*PG 3.59)*		
7	Have the bank balances in the Accounts been reconciled with the bank statements at 31 March? *(PG 3.50 – 3.58)*		
8	Have the Accounts been prepared on the proper basis (income and expenditure over £200,000) and is this consistent with last year? (*PG 3.68 – 3.79)*		
9	Have all debtors, creditors, receipts in advance, payments in advance and accruals been accounted for? (income and expenditure only) *(PG 3.72 – 3.79)*		

Governance		**YES**	**NO**
10	Are the accounts in balance and has all the necessary information been included in any supporting notes?		
11	If the council's income or expenditure is approaching a threshold (£200,000 or £1,000,000) have the implications of this been considered and acted upon? (*PG 2.6-2.7, 3.68-3.79)*		
The annual return			
12	Has Section 1 of the Annual Return been completed, signed by the **Responsible financial officer**, adopted by the Council and signed by the Chairman, including the minute reference and date? *(PG 2.4)*		
13	Has a copy of the **bank reconciliation** at 31 March been included with the Annual Return? (*PG 2.28)*		
14	Has a written and full explanation of any **significant variances** between last year's and this year's figures, or any unusual or unexpected amounts shown in the statement of accounts on section 1? *(PG 2.15)*		
15	Do the figures in section 1 of the annual return balance? (Balance b/fwd plus all receipts/income less all payments/expenditure equals balance c/fwd.) (*PG 3.68)*		
16	Has the Annual governance statement (section 2) been **completed and approved** by the Council, signed and dated by the Chairman and Clerk and the minute reference recorded? (*PG 2.37)*		
17	Has internal audit work been completed and the Certificate signed (section 4 of the Annual Return)? (*PG 2.58)*		
18	Has the Council considered and acted on any items appearing on the internal audit report for the financial year just ended? (*PG 2.58)*		
19	Has the Council considered and acted on any items appearing on the external auditor's report for the previous year? (*PG 2.46)*		
	If any 'no' answers appear above		
20	Does the clerk of the council/RFO need further advice or help in finalising the annual return? (contact SLCC/NALC audit help)		

Checklist carried out by

Date

Glossary

Accounts and Audit Regulations 2003 – SI 2003 No 533	Secondary legislation governing the arrangements for preparing and auditing the accounts of local authorities.
Accounts and Audit (Amendment) (England) Regulations 2006 SI 2006 No 564	Secondary legislation amending the Accounts and Audit Regulations 2003 introducing new thresholds, deadlines and review requirements.
Annual governance statement	A statement by the council which forms part of the annual return and sets out several representations or assertions which are intended to give the public assurance about the way in which the council has exercised key aspects of corporate governance.
Annual return	The return, specified by the Audit Commission, as the means by which local councils report to the public their statement of accounts, provide a annual governance statement in relation to key financial aspects of corporate governance and present the external auditor's opinion on the annual return. In addition the annual return includes a report from the council's internal auditor (this does not have to be published).
Appointed auditor	The external auditor appointed by the Audit Commission.
Audit Commission Act 1998	Primary legislation covering the accounts and audit requirements of local councils.
Balances	In financial statements the amounts in each item of account. Commonly used to refer to the sum of all cash and near cash held by the council for future use. See 'reserves'.
Code of Audit Practice	Prepared and issued by the Audit Commission, this Code is laid before Parliament at least every five years and provides the framework within which external auditors must carry out their audits.
Contingency	A provision (reserve) for the cost of an event or liability that may happen at some time in the future the true value of which is unknown.
Creditor	A person **to** whom a debt is owed.
Debtor	A person **from** whom a debt is owed.
Delegated authority	Formal approval by a council to officers and/or members to act on the council's behalf.

Fidelity Guarantee	A type of insurance against the risk of theft or defalcation by officers responsible for a council's assets, specifically cash and balances.
Governance (Corporate Governance)	The arrangements by which authorities direct their functions and relate to their communities.
Internal audit	A function, within or procured by the council, which is to review and report on the effectiveness of internal controls.
Internal control	An activity, process, system or measure to ensure that a local council's activities are carried out properly and as intended.
Internal control environment	The overall framework of internal controls and a key element in good corporate governance.
Local councils	See part 1 of the guidance for definitions.
Material/materiality	In the financial statements, information is material if its omission or misstatement could influence or mislead users of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement.
Opinion/Qualified opinion	A statement of findings and assurance given by an auditor following the completion of an audit process. A qualified opinion means that the auditor's otherwise positive assurance has been modified in some way usually to report non-compliance or other failure or weakness in the accounts.
Precept	A legal demand by a local council on its District Council (or other second tier body) for operating funds to meet budget needs. The precept is recovered from local taxpayers via council tax.
Representation	An assertion made within the annual return – see annual governance statement.
Reserves	Refers to balances of cash held for specific future purposes or generally to offset risks. Often referred to as 'balances'.
responsible financial officer ('RFO')	The officer, usually, the clerk designated by the council to ensure that the council maintains adequate accounting arrangements. RFOs have specific statutory responsibilities as set out in the Local Government Act 1972.

Risk management	The arrangements which a council makes to identify key business risks, evaluate these and put in place to measures to reduce the risk or manage the consequences of its occurrence.
Significance	In the financial statements refers to a measure of relative importance or having special meaning.
Statement of accounts	The section in the annual return which summarises the financial results of the council.
Tender	A bid to provide goods and/or services to the council. Invited from potential suppliers in accordance with Standing orders and Financial Regulations.
Ultra vires/Intra vires	Any activities which are beyond the powers of the local council, and so unlawful, are said to be ultra vires. *Intra vires* refers to activities which are within the legal powers of the council and therefore lawful.
Virement	Approved transfers of expenditure from one budget head to another.

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