Governance and Accountability for Smaller Authorities in England

A Practitioners' Guide to Proper Practices to be applied in the preparation of statutory annual accounts and governance statements

March 2016

This Guide is issued by the Joint Practitioners' Advisory Group (JPAG), and jointly published by the Society of Local Council Clerks, the National Association of Local Councils and the Association of Drainage Authorities.

JPAG is responsible for issuing proper practices in relation to the accounts of smaller authorities. Its membership consists of sector representatives from the Society of Local Council Clerks, the National Association of Local Councils and the Association of Drainage Authorities, together with stakeholder partners representing the Department of Communities and Local Government, the Department of Environment, Food and Rural Affairs, the Chartered Institute of Public Finance and Accountancy, the National Audit Office, and a representative of the external audit firms appointed to smaller authorities.

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Foreword

The Practitioners' Guide ('the guide') is issued by the Joint Practitioners' Advisory Group (JPAG) to support the preparation by smaller authorities in England of statutory annual accounting and governance statements found in the annual return.

This 2016 edition of the guide applies to annual returns in respect of financial years commencing on or after 1 April 2016. It can be applied voluntarily to annual returns covering the period 1 April 2015 to 31 March 2016 (with the exception outlined in paragraph 2.27 in Section 2 of the guide).

In accordance with Section 6 of the Local Audit and Accountability Act 2014, an authority is a 'smaller authority' if the higher of the authority's gross income for the year and its gross expenditure for the year does not exceed £6.5 million. For the purposes of the Accounts and Audit Regulations 2015, a smaller authority may also be referred to as a 'Category 2 authority'. This guide uses the term 'authority' to refer to all types of smaller authority.

Sections 1, 2 and 3 of the guide represent the proper accounting and governance practices *('proper practices')* referred to in statute. They set out for responsible finance officers the appropriate standard of financial and governance reporting for smaller authorities and are **mandatory**.

Section 4 of the guide sets out the non-statutory guidance relating to internal audit which authorities are required to take into account.

Section 5 of the guide (to be issued separately) provides supporting information and practical examples to assist smaller authorities to manage their governance and financial affairs and is not mandatory.

The guide is intended as a working tool for smaller authorities, providing not only the common 'rules' for completing an annual return for use by responsible finance officers, but also as a reference work for auditors, both internal and external, members, other officers and the public to aid understanding of the annual return and the reporting on the smaller authority's governance and finances within it.

For this reason, the guide is written with the intention to be as widely accessible as possible to all users within the constraints of it also representing the appropriate standards for public reporting by smaller authorities.

JPAG is committed to a regular review of the guide to ensure that it remains fit for purpose for all smaller authorities in England. The guide is supported by the technical support teams at SLCC, NALC and ADA where you may address any questions about the content of the guide or suggestions for its improvement.

Steve Parkinson
Chair, JPAG
March 2016

Section 1 - The Annual Governance Statement

Introduction

1.1 The Accounts and Audit Regulations 2015 require smaller authorities, each financial year, to conduct a review of the effectiveness of the system of internal control and prepare an annual governance statement in accordance with proper practices in relation to accounts.

1.2 This guide represents the proper practices in relation to accounts that smaller authorities need to follow in preparing their annual governance statement.

1.3 The purpose of the annual governance statement is for an authority to report publicly on its arrangements for ensuring that its business is conducted in accordance with the law, regulations and proper practices and that public money is safeguarded and properly accounted for.

1.4 Smaller authorities prepare their annual governance statement by completing Section 1 of the annual return. This is in the form of a number of statements, known as assertions, to which the authority needs to answer 'Yes' or 'No'. This guide follows the order of Section 1 of the annual return and sets out the actions that authorities need to have taken either during the financial year or after the financial year-end to answer 'Yes' to each assertion.

1.5 The authority needs to have appropriate evidence to support a 'Yes' answer to an assertion, for example a reference in a set of formal minutes.

1.6 If an authority is not able to respond 'Yes' to any assertion, it needs to provide an explanation to the external auditor on a separate sheet describing how the authority will address the weaknesses identified.

1.7 To assist practitioners, a pro-forma annual return is available alongside this guide.

Annual Governance Statement assertions

Assertion 1: Financial management and preparation of accounting statements

We have put in place arrangements for effective financial management during the year, and for the preparation of the accounting statements.

To warrant a positive response to this assertion, the following processes need to be in place and effective:

1.8 **Budgeting.** The authority needs to prepare and approve a budget in a timely manner before setting a precept or rates and prior to the commencement of the financial year. It needs to monitor actual performance against its budget during the year, taking corrective action where necessary. A financial appraisal needs to be undertaken before the authority commences any significant project or enters into any long term commitments.

1.9 **Accounting records and supporting documents**. All authorities, including parish meetings where there is no parish council, need to appoint an officer to be responsible for the financial administration of the authority in accordance with section 151 of the Local Government Act 1972. The authority needs to have satisfied itself that its Responsible Finance Officer (RFO) has determined a system of financial controls and discharged their duties under Regulation 4 of the Accounts and Audit Regulations 2015. The RFO needs to have put in place effective procedures to accurately and promptly record all financial transactions, and maintain up to date accounting records throughout the year, together with all necessary supporting information. The accounting statements in Section 2 of the annual return need to agree to the underlying records.

1.10 **Bank reconciliation.** Statements reconciling each of the authority's bank accounts with its accounting records need to be prepared on a regular basis, including at the financial year-end, and reviewed by members of the authority.

1.11 **Investments.** Arrangements need to be in place to ensure that the authority's funds are managed properly and that any amounts surplus to requirements are invested appropriately, in accordance with an approved strategy which needs to have regard to DCLG's statutory Guidance on local government investments. If total investments are to exceed £500,000 at any time during a financial year an authority needs to produce and approve an annual Investment Strategy in accordance with the DCLG guidance.

1.12 **Statement of accounts.** The authority needs to ensure that arrangements are in place to enable preparation of an accurate and timely statement of accounts in compliance with its statutory obligations and proper practices.

1.13 Supporting information on financial management and preparation of accounting statements can be found in Section 5.

Assertion 2: Internal Control

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

In order to warrant a positive response to this assertion, the following processes need to be in place and effective:

1.14 **Standing Orders and Financial Regulations.** The authority needs to have in place standing orders and financial regulations governing how it operates. Financial regulations need to incorporate provisions for securing competition and regulating the manner in which tenders are invited. These need to be regularly reviewed, fit for purpose, and adhered to.

1.15 **Safe and Efficient Arrangements to Safeguard Public Money.** Practical and resilient arrangements need to exist covering how the authority orders goods and services, incurs liabilities, manages debtors, makes payments and handles receipts.

1.15.1 Authorities need to have in place safe and efficient arrangements to safeguard public money. Where doubt exists over what constitutes money, the presumption is that that it falls within the scope of this guidance.

1.15.2 Authorities need to review regularly the effectiveness of their arrangements to protect money. Every authority needs to arrange for the proper administration of its financial affairs and ensure that one of its officers (the RFO) has formal responsibility for those affairs (see paragraph 1.9 above).

1.15.3 Authorities need to ensure controls over money are embedded in Standing Orders and Financial Regulations. Section 150(5) of the Local Government Act 1972 required cheques or orders for payment to be signed by two elected members. Whilst this requirement has now been repealed, the 'two member signatures' control needs to remain in place until such time as the authority has put in place safe and efficient arrangements in accordance with paragraphs 1.15.4 to 1.15.7 of this guide.

1.15.4 Authorities need to approve the setting up of, and any changes to, accounts with banks or other financial institutions. Authorities also need to approve any decisions to enter into 'pooling' or 'sweep' arrangements whereby the bank periodically aggregates the authority's various balances via automatic transfers.

1.15.5 If held, corporate credit card accounts need to have defined limits and be cleared monthly by direct debit from the main bank account.

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

1.15.7 Risk assessment and internal controls need to focus on the safety of the authority's assets, particularly money. Those with direct responsibility for money need to undertake appropriate training from time to time.

1.16 **Employment.** The remuneration payable to all employees needs to be approved in advance by the authority. In addition to having robust payroll arrangements which cover the accuracy and legitimacy of payments of salaries and wages, and associated liabilities, the authority needs to ensure that it has complied with its duties under employment legislation and has met its pension obligations.

1.17 **VAT.** The authority needs to have robust arrangements in place for handling its responsibilities with regard to VAT.

1.18 **Fixed Assets and Equipment.** The authority's assets need to be secured, properly maintained and efficiently managed. Appropriate procedures need to be followed for any asset disposal and for the use of any resulting capital receipt.

1.19 **Loans and Long Term Liabilities.** Authorities need to ensure that any loan or similar commitment is only entered into after the authority is satisfied that it can be afforded and that relevant approvals have been obtained. Proper arrangements need to be in place to ensure that funds are available to make repayments of capital and any associated interest and other liabilities.

1.20 **Review of effectiveness.** Regulation 6 of the Accounts and Audit Regulations 2015 requires the authority to conduct each financial year a review of the effectiveness of the system of internal control. The review needs to inform the authority's preparation of its annual governance statement.

1.21 Supporting information on internal control can be found in Section 5.

Assertion 3: Compliance with laws, regulations and proper practices

We took all reasonable steps to assure ourselves that there are no matters of actual or potential noncompliance with laws, regulations and proper practices that could have a significant financial effect on the ability of this smaller authority to conduct its business or on its finances.

In order to warrant a positive response to this assertion, the following processes need to be in place and effective:

1.22 **Acting within its powers.** All authorities' actions are controlled by statute. Therefore, appropriate decision making processes need to be in place to ensure that all activities undertaken fall within an authority's powers to act. In particular authorities need to have robust procedures in place to prevent any decisions or payments being made that are *ultra vires*, i.e. that the authority does not have the lawful power to make. The exercise of legal powers needs always to be carried out reasonably. For that reason, authorities making decisions need always to understand the power(s) they are exercising in the context of their decision making.

1.23 **General power of competence.** In particular an authority seeking to exercise a general power of competence under the Localism Act 2011 needs to ensure that the power is fully understood and exercised in accordance with the Parish Councils (General Power of Competence) (Prescribed Conditions) Order 2012.

1.24 **Regulations and proper practices.** Procedures need to be in place to ensure that an authority's compliance with statutory regulations and applicable proper practices is regularly reviewed and that new requirements, or changes to existing ones, are reported to members and applied. Authorities need to have particular regard to the requirements of the Accounts and Audit Regulations 2015.

1.25 **Actions during the year.** An authority needs to have satisfied itself that it has not taken any decision during the year, or authorised any action, that exceeds its powers or contravenes any laws, regulations, or proper practices.

1.26 Supporting information on compliance with laws, regulations and proper practices can be found in Section 5.

Assertion 4: Exercise of public rights

We provided proper opportunity during the year for the exercise of electors' rights in accordance with the requirements of the Accounts and Audit Regulations.

In order to warrant a positive response to this assertion the authority needs to have taken the following actions in respect of the previous year's annual return[1]:

1.27 **Exercise of public rights.** The authority provided for the exercise of public rights set out in Sections 26 and 27 of the Local Audit and Accountability Act 2014. Part 5 of the Accounts and Audit Regulations 2015 requires the RFO to have published, including on the authority's website or other website:

- Sections 1 and 2 of the annual return;
- a declaration that the status of the statement of accounts is 'unaudited'; and
- a statement that sets out details of how public rights can be exercised, as set out in Regulation 15(2)(b), which includes the period for the exercise of public rights.

1.28 **External Auditor's Review.** A notice of the conclusion of the external auditor's limited assurance review of the annual return, together with relevant accompanying information, was published (including on the authority's website or other website) in accordance with the requirements of Regulation 16 the Accounts and Audit Regulations 2015.

1.29 A parish meeting may meet the publication requirements by displaying the information in question in a conspicuous place in the area of the authority for at least 14 days.

1.30 Supporting information on the exercise of public rights can be found in Section 5.

[1] If the annual return referred to is that for 2014/15 (in the case of voluntary application of this guide to the annual return for 2015/16), the relevant legislation was the Audit Commission Act 1998 and the Accounts and Audit (England) Regulations 2011.

Assertion 5: Risk Management

We carried out an assessment of the risks facing this smaller authority and took appropriate steps to manage those risks, including the introduction of internal controls and/or external insurance cover where required.

In order to warrant a positive response to this assertion, the authority needs to have the following arrangements in place:

1.31 **Identifying and assessing risks.** The authority needs to identify, assess and record risks associated with actions and decisions it has taken or considered taking during the year that could have financial or reputational consequences.

1.32 **Addressing risks.** Having identified, assessed and recorded the risks, the authority needs to address them by ensuring that appropriate measures are in place to mitigate and manage risk. This might include the introduction of internal controls and/or appropriate use of insurance cover.

1.33 Supporting information on risk management can be found in Section 5.

Assertion 6: Internal Audit

We maintained throughout the year an adequate and effective system of internal audit of the accounting records and control systems.

In order to warrant a positive response to this assertion, the authority needs to have taken the following actions:

1.34 **Internal audit.** The authority needs to undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes taking into account internal auditing guidance for smaller authorities.

1.35 **Provision of information.** The authority needs to ensure it has taken all necessary steps to facilitate the work of those conducting the internal audit, including making available all relevant documents and records and supplying any information or explanations required.

1.36 Non-statutory guidance on internal audit can be found in Section 4.

Assertion 7: Reports from Auditors

We took appropriate action on all matters raised in reports from internal and external audit.

1.37. To warrant a positive response to this assertion, the authority needs to have considered all matters brought to its attention by its external auditor and internal audit and taken corrective action as appropriate.

1.38. Supporting information on reports from auditors can be found in Section 5.

Assertion 8: Significant events

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

To warrant a positive response to this assertion, the authority needs to have taken the following actions where necessary:

1.39. **Significant events.** The authority needs to have considered if any events that occurred during the financial year (or after the year-end), have consequences, or potential consequences, on the authority's finances. If any such events are identified, the authority then needs to determine whether the financial consequences need to be reflected in the statement of accounts.

1.40. Supporting information on significant events can be found in Section 5.

Assertion 9: Trust Funds (local councils only)

Trust funds (including charitable). In our capacity as the sole managing trustee we discharged our accountability responsibilities for the fund(s)/assets, including financial reporting and, if required, independent examination or audit.

1.41. Where a local authority acts as a sole managing trustee for a trust or trusts, to warrant a positive response to this assertion the authority needs to have made sure that it has discharged all of its responsibilities with regard to the trust's finances. This needs to include financial reporting and, if required, independent examination or audit. This is notwithstanding the fact that the financial transactions of the trust do not form part of the authority's accounts and are therefore not included in the figures reported on Section 2 of its annual return (see paragraph 2.30 below).

1.42. Supporting information on trust funds can be found in Section 5.

Approval process

1.43. The authority needs to approve the annual governance statement by resolution of members of the authority meeting as a whole, in advance of the authority approving the accounting statements in Section 2 of the annual return. The Chair of the meeting and the Clerk need to sign and date the annual governance statement and a minute reference entered.

Section 2 - The Statement of Accounts

Introduction

2.1. The Local Audit and Accountability Act 2014 and the Accounts and Audit Regulations 2015 require all authorities to prepare a statement of accounts for each financial year in accordance with proper practices. This guide presents the proper practices in relation to accounts that smaller authorities need to follow in preparing their annual accounts and follows the order set out in Section 2 of the annual return. To assist practitioners, a pro-forma annual return is available alongside this guide.

2.2. For smaller authorities the statement of accounts needs to be prepared in accordance with, and in the form specified in, any annual return required by these proper practices in relation to accounts.

2.3. Section 2 of the annual return is a smaller authority's statement of accounts and takes the form of a summary income and expenditure account and a statement of balances. Where an authority's gross income or expenditure is not more than £200,000 for that year, or for either of the two immediately preceding financial years, the statement may take the form of a summary receipts and payments account.

2.4. An authority's statement of accounts needs to be in the form set out in Section 2 of the annual return. The figures entered in the relevant cells are the authority's receipts and payments for the year, or its income and expenditure, as appropriate. This guide assumes that most authorities maintain current records on a receipts and payments basis and convert these to income and expenditure at the year end, if necessary. Information and examples on the conversion process from receipts and payments to income and expenditure is provided in Section 5 and does not form part of proper practices.

2.5. All highlighted cells of the annual return need to be completed, including writing 'nil' or '0' in any cell that does not apply. Leaving cells blank may lead to questions by readers who may not be sure if the compiler intended a nil balance or whether an omission or error has occurred.

2.6. All figures in Section 2 of the annual return need to agree to the authority's primary accounting records. The RFO needs to be able to show how the figures in the annual return reconcile to those in the cashbook and other primary accounting records. Members need to see this reconciliation when they are asked to approve the statement of accounts in the annual return. Interested persons inspecting the accounts have a legal right to inspect the accounting records and all books, deeds, contracts, bills, vouchers, receipts and other documents relating to those records, including this reconciliation.

2.7. The accounting statements present two years accounts for the authority, side by side. The prior year figures can be taken directly from the previous year's annual return or, if this is the first year of accounts, the prior year figures will all be £0.

2.8. The figures for the preceding financial year are shown in the first column so that members, local electors, residents and other interested parties can easily see any significant changes that have occurred during the current year and help to set the context in which the accounts need to be viewed.

2.9. Where an error has been identified in the prior year's accounts, after the external auditor's review, which has resulted in the carried forward figure in Line 7 being amended, then the corrected figure needs to be carried forward to the current year's annual return. The authority must clearly indicate that the prior year column in the accounting statements is 'Restated' and inform the external auditor.

2.10. Authorities that change the basis on which their accounts are presented, i.e. from income and expenditure to receipts and payments (or vice versa), need to ensure that the comparative accounts in the annual return are shown on a consistent basis and are reported in Section 2 of the annual return by adding the word 'Restated' at the top of the prior year column, and explained by means of a note to the auditor.

Accounting statements

Line 1: Balances brought forward

2.11. This cell shows the opening figure for the summary of the smaller authority's annual accounts. It is the closing balance carried forward from the previous year's accounting statements – see paragraph 2.19 below. The amount in the current year cell in Line 1 should be the same figure as the 'balances carried forward' figure in the prior year column at Line 7.

Line 2: Precept or Rates and Levies

2.12. For precepting authorities, this cell shows the total precept received or receivable in the year. For internal drainage boards this cell shows the total of rates and special levies received or receivable in the year. This cell should contain only the value of precepts or rates and levies received or receivable in the year. Any other receipts, including grants, are to be included in Line 3.

Line 3: Total other receipts

2.13. This cell shows the authority's total income or receipts for the year, less the precept or rates and levies figure shown in Line 2. It will therefore include any repaid investments, any monies borrowed to finance projects, proceeds from the sale of fixed assets, fees, charges, and grants such as council tax support grant.

2.14. Compilers of the accounting statements must exclude from the figure shown in Line 3 the value of any transactions recorded in the authority's accounting records arising from daily cash management activities. These transactions include transfers between bank current and deposit accounts and other short-term deposits. It is correct to record such transactions in the cash book for control and reconciliation purposes. However, they are not reported in the accounting statements because these transfers do not represent either receipts or payments, or income or expenditure for the authority.

Line 4: Staff costs

2.15. This cell shows all the costs incurred by the authority in relation to the employment of its staff. It includes employment expenses which are benefits (for example, mileage and travel expenses) but it does not include payments made in respect of office expenses reimbursed to employees or the costs of engaging agency staff or consultants (these expenses form part of the amount shown in Line 6). Where the authority 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.

Line 5: Loan interest/capital repayments

2.16. This cell shows the total of capital and interest payments made by the authority in the year. It includes repayment of loan principal, whether as part of a scheduled repayment plan or as a special payment, and interest arising from any borrowing including bank overdrafts and credit cards.

2.17. Authorities preparing income and expenditure accounts need to make a provision in their accounts for any accrued interest payable at the year-end in accordance with the terms of any loan. The accrued value of unpaid interest due would be shown in this cell.

Line 6: All other payments

2.18. This cell shows the authority's total expenditure or payments made in the year, less the total of the specific expenditure amounts shown in Lines 4 and 5. It will include the costs of purchasing fixed assets and undertaking capital projects as well as the costs of providing day to day services. Payments made in respect of investments need to be included, but not entries that result from daily cash management activities, such as transfers between bank current and deposit accounts or the making of short-term investments – see 2.14 above.

Line 7: Balances carried forward

2.19. This cell shows the closing figure for the balances of the authority after all of its financial transactions have been accounted for. The cell value is calculated by adding the amounts in Lines 2 and 3 to the balances brought forward in Line 1 and then deducting the sum of the amounts in Lines 4, 5 and 6.

Line 8: Total value of cash and short-term investments

2.20. This cell shows the actual value of the authority's cash and short-term investments in the form of cash held, current and deposit accounts plus any short-term investments. The figure should be equal to the corresponding figure in the authority's cash book.

2.21. Short-term investments, which mainly include deposit and savings accounts typically provided by banks, are those that display the following characteristics:

- are denominated in pounds Sterling;
- have a maturity of less than 12 months;
- the whole of the original sum invested can, from the time that the investment is made, be accessed for use by the authority without any reduction; and
- the authority has assessed the counterparty and is satisfied that the original sum invested is not subject to unreasonable risk.

2.22. For authorities preparing accounts on a receipts and payments basis, the figure in Cell 8 will be the same that shown at Cell 7. For other authorities a statement needs to be prepared explaining the difference by reference to the adjustments that have been made to convert the accounts to an income and expenditure basis, particularly accounting for debtors, creditors and provisions. Further information and examples on converting accounts from receipts and payments to income and expenditure are provided in Section 5.

2.23. The authority will need to reconcile this figure to its year-end bank account statements and submit the reconciliation to the external auditor. Further information on bank reconciliations can be found in Section 5.

Line 9: Total fixed assets plus long-term investments and assets

2.24. This cell shows the value of all the property the authority owns. It is made up of its fixed assets and long-term investments. The term fixed assets means the property, plant and equipment used by the authority to deliver its services. A long-term investment arises where the authority invests money in anything other than a short-term investment.

2.25. Authorities need to maintain a register of the fixed assets, long-term investments and other non-current assets that they hold.

2.26. The value of the cell at Line 9 is taken from the authority's asset register which is up to date at 31 March and includes all capital acquisition and disposal transactions recorded in the cash-book during the year. Authorities need to apply a reasonable approach to asset valuation which is consistent from year to year. Where an authority changes its method of asset valuation during a financial year, it will need to restate the prior year's figure in Line 9 of the annual return.

2.27. If an authority, other than an IDB, voluntarily applies this guide to its annual return for 2015/16, the asset register value of its assets at 31 March 2016 needs to be stated in Line 9 in accordance with the Practitioners' Guide for local councils issued in March 2014. This is a transitional requirement that applies to the 2015/16 annual return only.

2.28. Further information on fixed assets and long-term investments can be found in Section 5.

Line 10: Total borrowings

2.29. This cell shows the outstanding capital balance of all borrowings from third parties at the end of the year, including all loans but excluding bank overdrafts. Authorities need to maintain a record of all borrowings and similar credit arrangements entered into, other than temporary bank overdrafts. Further information can be found in Section 5.

Line 11: Disclosure note re Trust funds (local councils only)

2.30. This cell requires a local council only to answer 'yes' or 'no' to whether it acts as sole trustee for, and is responsible for managing, Trust funds or assets. The council needs to ensure that the accounting statements in Section 2 of the annual return do not include any Trust transactions or balances (see paragraph 1.41 above).

Signature of Responsible Finance Officer

2.31. Notwithstanding who prepared the statement of accounts, it is the responsibility of the authority's RFO to certify it as either presenting fairly the financial position of the authority or properly presenting its receipts and payments, as the case may be. In so certifying the RFO confirms that proper practices have been followed in preparing the statement of accounts.

Signature of Chairman

2.32. After the RFO has signed the statement of accounts, the members of the authority meeting as a whole need to consider it and approve it by resolution. Alongside the RFO's certificate, the person presiding at the meeting at which the statement of accounts is approved needs to confirm, by signing and dating the statement at the bottom of Section 2 of the annual return, that the accounts have been approved by the authority in accordance with the Accounts and Audit Regulations 2015.

2.33. The authority needs to ensure that the accounting statements are signed by the RFO and approved by the authority, by the latest date in order for the RFO to comply with the duty to commence the period for the exercise of public rights so that it includes the first ten working days of July.

Accompanying information

2.34. There is no provision in the annual return for additional notes to explain and expand on the figures shown in the accounting statements. To address this, authorities need to provide the following accompanying information to the external auditor:

Explanation of variances

2.35. Authorities need to understand the changes in income and expenditure from year to year and their significance. The RFO needs to produce an explanation of significant variances in annual levels of income, expenditure and balances shown in Section 2 of the annual return that provides a sufficiently detailed and meaningful analysis and explanation of the reasons for the change.

Bank Reconciliation.

2.36. The year-end bank reconciliation (see paragraph 1.10 above) needs to be provided to the external auditor together with the annual return and other accompanying documentation.

2.37. The external auditor may request that other information is provided to support their review of the annual return. The authority needs to comply with any such requests.

2.38. Supporting information on completion of the accounting statements can be found in Section 5.

Section 3: Proper practices in relation to accounts for a smaller authority that has decided to prepare accounts and be audited as a full audit authority

Introduction

3.1. Regulation 8(1) of the Local Audit (Smaller Authorities) Regulations 2015 allows smaller authorities with annual turnover exceeding £25,000 to decide to prepare a statement of accounts and be audited as if it were a relevant authority that is not a smaller authority. This is defined in the Regulations as a 'full audit authority'.

3.2. For the purposes of the Accounts and Audit Regulations 2015, a full audit authority is treated as a Category 1 authority.

3.3. Regulation 7 of the Accounts and Audit Regulations 2015, requires a Category 1 authority to prepare a statement of accounts in accordance with the regulations and proper practices in relation to accounts. Regulation 5 requires a Category 1 authority to prepare an annual governance statement in accordance with proper practices in relation to accounts.

3.4. The proper practices in relation to accounts for a full audit authority are set out in this guidance issued by JPAG.

Proper practices – Statement of accounts

3.5. JPAG recommends that, for financial years commencing on or after 1 April 2016, a full audit authority should follow the proper accounting practices found in UK GAAP (FRS 102) issued by the Financial Reporting Council[2].

3.6. Alternatively, a full audit authority may adopt as proper practices the Code of Practice on Local Authority Accounting in the UK issued by CIPFA/LASAAC.

Proper practices – Annual governance statement

3.7. JPAG recommends that a full audit authority should follow *Delivering Good Governance in Local Government: Framework*, published by CIPFA and SOLACE in 2007 and its subsequent addendum, published in 2012, which provides an updated example annual governance statement. A full audit authority may also wish to refer to *Delivering good governance in local government: A guidance note for English authorities,* published by CIPFA/SOLACE in 2012, which is intended to assist authorities

[2] The Financial Reporting Standard for Smaller Entities (the FRSSE) has been withdrawn for financial years commencing on or after 1 January 2016.

in reviewing their governance arrangements and can be used in conjunction with the Framework and the addendum.

3.8. Alternatively, a full audit authority may use the annual governance statement in Section 1 of the annual return (see Section 1 of this guide and the pro-forma annual return available alongside this guide).

Section 4: Non-statutory guidance for internal audit at smaller authorities

Introduction

4.1. A smaller authority is required by Regulation 5(1)of the Accounts and Audit Regulations 2015 to 'undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance.'

4.2. The public sector internal audit standards, issued in 2013, have not been applied to smaller authorities. The information in this section of the Practitioners' Guide is therefore the non-statutory 'guidance' referred to in Regulation 5(1), and needs to be taken into account by smaller authorities in undertaking an effective internal audit.

Overview of internal audit

4.3. Internal auditing is an independent, objective assurance activity designed to improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

4.4. The purpose of internal audit is to review and report to the authority on whether its systems of financial and other internal controls over its activities and operating procedures are effective.

4.5. The internal audit function must be independent from the management of the financial controls and procedures of the authority which are the subject of review. The person or persons carrying out internal audit must be competent to carry out the role in a way that meets the business needs of the authority. It is for each authority to decide, given its circumstances, what level of competency is appropriate, and to keep this issue under review.

4.6. Internal audit is an on-going function, undertaken regularly throughout the financial year, to test the continuing existence and adequacy of the authority's internal controls. It results in an annual assurance report to members designed to improve effectiveness and efficiency of the activities and operating procedures under the authority's control. Managing the authority's internal controls is a day-to-day function of the authority’s staff and management, and not the responsibility of internal audit.

4.7. Internal audit does not involve the detailed inspection of all records and transactions of an authority in order to detect error or fraud.

Appointing an internal audit provider

4.8. It is a matter for the authority to determine how best to meet the statutory requirement for internal audit, having regard to its business needs and circumstances.

4.9. There are two key principles an authority should follow in sourcing an internal audit provider: independence and competence.

Independence

4.10. Independence requires the absence of any actual or perceived conflict of interest. It means that whoever carries out the internal audit role does not have any involvement in or responsibility for the financial decision making, management or control of the authority, or with the authority’s financial controls and procedures.

4.11. It follows, for example, that the circumstances in which a member could demonstrate that they are sufficiently independent of the financial decision making and procedures of the authority are difficult to envisage. Such a member would need to exclude themselves entirely from key financial decisions by the authority in order to maintain their independence. Similarly, it would not be appropriate for any individual or firm appointed by the authority to assist with the authority’s accounting records, preparation of financial statements or the annual return, to be also appointed to undertake the internal audit function. Conflicts of interest must be avoided, such as in cases where an external provider of accounting software or services to the authority, also offers internal audit services through an associate company, firm or individual.

Competence

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

- understanding basic book-keeping and accounting processes;

- understanding the role of internal audit in reviewing systems rather than undertaking detailed checks that are more appropriately the responsibility of management;
- awareness of relevant risk management issues; and
- understanding proper practices in relation to governance and accounting requirements within the legal framework and powers of smaller authorities.

4.13. There are various ways for an authority to source an internal audit service, for example:

- Appointing a local individual or a member of a panel of individuals administered by a local association or branch of NALC, SLCC or ADA. An individual will need to demonstrate adequate independence and competence to meet the needs of the authority.
- Employing a competent internal auditor with sufficient organisational independence and status to undertake the role.
- Purchasing an internal audit service from a principal local authority.
- Purchasing an internal audit service from a local firm or specialist internal audit practice. The firm needs to have an understanding of the local government legal framework and a number of professional firms offer a service to public bodies, authorities and commercial companies. For the largest authorities a specialist contractor appointment may be appropriate.

Scope of internal audit

4.14. It is a matter for the authority to determine the necessary scope and extent of its internal audit. When securing an internal audit service, the authority should make sure that it is proportionate to the needs, size and the circumstances of the authority.

4.15. The work of internal audit should be subject to an engagement letter on first appointment by the authority, 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 authority.

4.16. Each authority should set out its key financial and other controls, usually in the form of standing orders and financial regulations. The smaller the authority, the less onerous these need to be. Similarly, the scope of internal audit at smaller authorities will be correspondingly less than at larger ones. The more complex the authority is or becomes, in terms of its organisation, range of services and number of employees the wider ranging the scope of internal audit may be.

4.17. It is not possible to draw up a standard internal audit programme to cover all authorities. This is because the audit programme must address the particular needs of each authority. Internal audit's function is to test and report to the authority on whether its specific system of internal control is adequate and working satisfactorily.

Annual internal audit report

4.18. The duties of internal audit relate to reporting on the adequacy and effectiveness of an authority's system of internal control. The minimum reporting requirement for internal audit to the smaller authority is met by completing the annual internal audit report on page 5 of the annual return. Internal audit may also report in greater detail to the authority as required.

4.19. The annual internal audit report focuses on ten internal control objectives covering an authority's key financial and accounting systems and concludes whether, in all significant respects, the internal control objectives were being achieved throughout the financial year to a standard adequate to meet the needs of the authority.

4.20. The annual internal report will inform the authority's response to assertions 2 and 6 in the annual governance statement.

Reviewing internal audit

4.21. Authorities should from time to time carry out a review of the effectiveness of their overall internal audit arrangements. The review should take place at least once every three years and also in the year of any change of internal audit provider or responsible finance officer. Any review should balance the authority's internal audit needs and usage. It should be designed to provide sufficient assurance for the authority that standards are being met and that the work of internal audit is effective. Authorities judge the extent and scope of the review by reference to their own individual circumstances.

4.22. The review should be designed to assure the authority that it has maintained the standards of an adequate and effective internal audit of its risk management, control and governance processes. It should include, as a minimum, making an assessment of each of the following:

- the scope of internal audit;
- independence;
- competence;
- relationships with the clerk and the authority; and
- audit planning and reporting.

4.23. The review should be undertaken by the authority. It should not be undertaken by the external auditor or as part of the external auditor's review of the annual return, nor can it be delegated to an officer. Clearly it cannot be undertaken by internal audit, although it is good practice to seek their involvement in the process. Authorities may wish to set up a small working party to carry out the review or utilise an existing committee. Whatever approach is followed, the results should be reported to a full meeting of the authority.

4.24. There is no single approach to review of internal audit that will suit all authorities. Much will depend upon the size of the authority and arrangements it already has in place for conducting the wider review of its system of internal control and risk management generally. The areas described above in paragraph 4.23 will normally be the starting point, but the effectiveness of internal audit should not be judged solely by the extent of compliance with expected standards. The review is primarily about effectiveness, not process. In essence, the focus of this review should be on the quality of delivery of the internal audit service, i.e. reliable assurance about the authority's internal controls and its management of risk.

4.25. As with any review, it should be evidence based. Wherever possible this should be gathered throughout the year. Sources may include:

- previous review and action plan;

- annual report by internal audit;
- periodic reports from internal audit, including internal audit plan, monitoring reports, and the results of any investigations;
- any reports by the external auditor; and
- the results of any other external reviews of internal control.

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