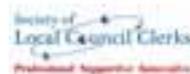




# Governance and Accountability for Local Councils

A Practitioners' Guide (England)  
2010



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# 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.

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

Since 2005, the guide no longer applies to community councils in Wales which operate within a quite separate, albeit very similar, legal framework. We are grateful to colleagues from Wales who continue to participate as full partners in JPAG although the responsibility for producing guidance has now transferred to Wales.

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

In 2007 JPAG took on responsibility for delivering proper accounting practices guidance for larger IDBs. In 2009 JPAG also became responsible for proper accounting practices for the largest local councils in England. This third edition of the guide presents for the first time accounting guidance for those bodies.

The current members of the Joint Practitioners Advisory Group are:

Paul Mayers, Audit Commission (Chair until December 2009)

Alan Fairchild, Society of Local Council Clerks (SLCC)

Graham Fletcher, Department of Communities and Local Government (CLG)

Phil Winrow, Environment Agency (EA) and Department for Environment Food and Rural Affairs (Defra)

Peter Lacey, National Association of Local Councils (NALC) (Chair from January 2010)

Phil Camamile, Water Management Alliance and the Association of Drainage Authorities (ADA)

Laura Deery, Certified Institute of Public Finance and Accounting (CIPFA)

Stephen Christopher, Mazars (representing Small Body Auditors Group)

Mark Lewis, Audit Commission Legal Advisor

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

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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.

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# 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 is required for larger bodies, it remains responsive to the need to safeguard the proper conduct of public business by local councils.
- 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.

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# Introduction

- 8 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.
- 9 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.
- 10 The accountability and audit framework applies to all local councils. However, it is appropriate that the largest local councils continuously operating above an annual income or annual expenditure threshold (currently £1 million) should account more rigorously than smaller councils. In Part 4 we provide information for the largest local councils.
- 11 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 to where they may find guidance on proper accounting practices.
  - **Appendices** provide additional information and tools for practitioners.
  - A **glossary** of words and phrases commonly used is included at the end of this guidance.
- 12 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.

- 13 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 and its technical working parties. These arrangements are intended to provide sources of further support and guidance for practitioners, and, from time to time, the guidance in this document will be updated and revised as appropriate.
- 14 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 Web link: <http://www.audit-commission.gov.uk/nationalstudies/localgov/Pages/councilsaccountsyourrights03072006.aspx>

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# 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.**

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## **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 the accounts of 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 them. 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 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 are established where former cities and boroughs became part of district councils or Unitary Authorities but do not become parish councils. The powers and duties of Charter Trustees are contained in the Charter Trustee Regulations. 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 accounting statements annually in the format specified in the annual return and to have an annual 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. Therefore, where joint committees are carrying out delegated functions involving the spending of public money, the Audit Commission appoints an external auditor. Although they are not independent legal entities, for the purposes of keeping accounts and submitting to audit, Joint Committees are 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.

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## **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.<sup>1</sup>

**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.

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## **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.

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<sup>1</sup> See paragraph 7 in the Introduction section above for a link to more detailed guidance on electors' rights

- 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.
- 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.

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### **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 2010 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.

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## **‘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*<sup>11</sup>, in which the proper practices in relation to both the accounts and internal audit may be found.

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## **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.

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<sup>11</sup> 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'.

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# 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.

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## 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.

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### **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<sup>1</sup>. 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.

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<sup>1</sup> 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

- 2.7** 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 accounting statements 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 accounting statements 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.
- 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 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.

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### **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.

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.

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## **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.

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## **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<sup>ii</sup> and relevant legislation<sup>iii</sup>.

**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 bank and building society 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.

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<sup>ii</sup> See Appendix 8.1: Local Government Investments – guidance under section 15(1)(a) of LGA2003 letter 12 March 2004 and guidance issued 11 March 2010 (appendix 8.2)

<sup>iii</sup> In particular, Local Government Act 2003 s 16 and Regulation 25 of the Capital Finance Regulations 2003

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.

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### 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 approval of the accounting statements may be delegated to a committee of the council. However, the annual return as a whole including the annual governance statement must be approved at a full council meeting.

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 accounting statements which have 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.

2.43A 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.'*

2.44The 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.

2.45The 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.'*

2.46The 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 accounting statements.'*

2.47The 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.

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### **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 accounting statements. 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 2.97 below).

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#### **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* 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.
- 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 2.71 below.*

**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\*;
- local panels of officers (usually clerks) providing internal audit services to each other and sometimes wider afield\*;
- local residents who are retired accountants;
- local residents who are former members or clerks of the local council;
- local bank managers (some high street banks have community development policies which encourage their officers to take part in community activities – they are not allowed to charge);
- local business owners and managers – a number of larger corporations have policies similar to the banks with regard to community action;
- independent examiners for local charities;
- specialist internal audit service providers operating on a fixed fee or on an hourly rate;
- consortia organised by the 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.

\*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.

	<b>Subject</b>	<b>Guidance</b>
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.

	<b>Subject</b>	<b>Guidance</b>
2	Financial Regulations Standing Orders Payment Controls	<p>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.</p> <p>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.</p> <p>In purchase order procedures:</p> <ul style="list-style-type: none"> <li>• 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);</li> <li>• that proper purchase authority by council, a committee or officers (under clear delegated powers) is in place; and</li> <li>• that a proper legal power has been identified for the expenditure.</li> </ul> <p>In purchase payments:</p> <ul style="list-style-type: none"> <li>• that the supporting paperwork confirms that there is a fully approved invoice and authorisation for payment; and</li> <li>• that VAT is identified appropriately for reclaim.</li> </ul> <p>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.</p> <p>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.</p>

	<b>Subject</b>	<b>Guidance</b>
		<p>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.</p> <p>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.</p>
3	Risk management	<p>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.</p> <p>More guidance regarding risk management can be found in this section at paragraph 2.97.</p>
4	Budgetary controls	<p>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.</p> <p>More guidance on the budgetary process can be found in Part 3, paragraph 3.29 onwards.</p>

	<b>Subject</b>	<b>Guidance</b>
5	Income controls	<p>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.</p> <p>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.</p>
6	Petty cash procedure	<p>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.</p>

	<b>Subject</b>	<b>Guidance</b>
7	Payroll controls	<p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p>

	<b>Subject</b>	<b>Guidance</b>
8	Asset control	<p>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 (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.</p>
9	Bank reconciliation	<p>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.</p> <p>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.</p> <p>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.</p>

	<b>Subject</b>	<b>Guidance</b>
		<p>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.</p> <p>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.</p>
10	Year-end procedures	<p>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.</p>

**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.

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

## 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 council's services, risk management and corporate governance arrangements.		
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.		

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## **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.
- 2.104** 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.
- 2.105** 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.
- 2.106** 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.
- 2.107** 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.
- 2.108** 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, it impedes the council's ability to bid for funds in future.
- 2.109** 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.
- 2.110** 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.

2.111 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.

2.112 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).

2.113 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.

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

<b>Risk identification</b>
<p>Insurance cover for risk is the most common approach to certain types of inherent risks.</p> <ul style="list-style-type: none"> <li>✓ The protection of physical assets owned by the council – buildings, furniture, equipment, etc (loss or damage).</li> <li>✓ 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).</li> <li>✓ 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).</li> <li>✓ Loss of cash through theft or dishonesty (fidelity guarantee).</li> <li>✓ Legal liability as a consequence of asset ownership (public liability).</li> </ul>
<b>Internal controls</b>
<p>A council's internal controls may include the following.</p> <ul style="list-style-type: none"> <li>✓ An up to date register of assets and investments.</li> <li>✓ Regular maintenance arrangements for physical assets.</li> <li>✓ Annual review of risk and the adequacy of cover.</li> <li>✓ Ensuring the robustness of insurance providers.</li> </ul>

**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**

<b>Risk identification</b>
<p>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.</p> <ul style="list-style-type: none"> <li>✓ Security for vulnerable buildings, amenities or equipment.</li> <li>✓ Maintenance for vulnerable buildings, amenities or equipment.</li> <li>✓ The provision of services being carried out under agency/partnership agreements with principal authorities.</li> <li>✓ Banking arrangements, including borrowing or lending.</li> <li>✓ Ad hoc provision of amenities/ facilities for events to local community groups.</li> <li>✓ Markets management.</li> <li>✓ Vehicle or equipment lease or hire.</li> <li>✓ Trading units (leisure centres, playing fields, burial grounds, etc).</li> <li>✓ Professional services (planning, architects, accountancy, design, etc).</li> </ul>
<b>Internal controls</b>
<p>A council's internal controls may include the following.</p> <ul style="list-style-type: none"> <li>✓ Standing orders and financial regulations dealing with the award of contracts for services or the purchase of capital equipment.</li> <li>✓ Regular reporting on performance by suppliers/providers/contractors.</li> <li>✓ Annual review of contracts.</li> <li>✓ Clear statements of management responsibility for each service.</li> <li>✓ Regular scrutiny of performance against targets.</li> <li>✓ Adoption of and adherence to codes of practice for procurement and investment.</li> <li>✓ Arrangements to detect and deter fraud and/or corruption.</li> <li>✓ Regular bank reconciliation, independently reviewed.</li> </ul>

**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.
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**Table 3 Areas where there may be a need to self-manage risk**

<b>Internal controls</b>
<p>A council's internal controls may include the following.</p> <ul style="list-style-type: none"><li>✓ Regular scrutiny of financial records and proper arrangements for the approval of expenditure.</li><li>✓ Recording in the minutes the precise powers under which expenditure is being approved.</li><li>✓ 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.</li><li>✓ Regular returns of VAT; training the responsible officer in matters of VAT and other taxation issues as necessary.</li><li>✓ Regular budget monitoring statements.</li><li>✓ Developing systems of performance measurement.</li><li>✓ Procedures for dealing with and monitoring grants or loans made or received.</li><li>✓ Minutes properly numbered and paginated with a master copy kept in safekeeping.</li><li>✓ Documented procedures to deal with enquiries from the public.</li><li>✓ Documented procedures to deal with responses to consultation requests.</li><li>✓ Monitoring arrangements by the council regarding Quality Council status.</li><li>✓ Documented procedures for document receipt, circulation, response, handling and filing.</li><li>✓ Procedures in place for recording and monitoring Members' interests and Gifts and Hospitality received.</li><li>✓ Adoption of codes of conduct for members and employees.</li></ul>

**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.
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# Part 3 – Accounting guidance for small local councils

This part provides guidance on how local councils meet their statutory responsibilities most effectively, particularly in relation to the preparation of the annual accounting statements (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.

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## Introduction

3.1 The Accounts and Audit Regulations provide a comprehensive framework for the accounts of a local council, taking the wider definition of what constitutes 'the accounts' as:

- the day-to-day records of financial activity that help with the management of the council's funds – the books of account; and
- the summary of the council's financial activity that is prepared at the end of each year for reporting to the public – the accounting statements (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 accounting statements, in that the accounting statements are compiled from the information recorded in the books. But the books of account are important in themselves in the running of the council throughout the year. A good set of books will allow a council to appreciate at any time:

- 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 accounting statements comply 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 uncollectible 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.

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## **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.

<b>Statutory duty</b>	<b>Possible arrangements</b>
<p>1 The responsible financial officer determines the body's accounting system and the form of its accounts and supporting accounting records.</p>	<ul style="list-style-type: none"> <li>• 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.</li> <li>• 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.</li> <li>• 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.</li> </ul>
<p>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.</p>	<ul style="list-style-type: none"> <li>• 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.</li> <li>• 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.</li> <li>• The proper practices specified by the Accounts and Audit Regulations, are represented by the contents of this guidance.</li> <li>• 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.</li> </ul>

<b>Statutory duty</b>	<b>Possible arrangements</b>
<p>3 The accounting records are sufficient to show the body's transactions and to enable the responsible financial officer to ensure that the accounting statements comply with the Accounts and Audit Regulations.</p>	<ul style="list-style-type: none"> <li>• 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.</li> <li>• Accounting records will be sufficient to ensure that the accounting statements comply with the Accounts and Audit Regulations, if they allow the analysis of transactions in accordance with section 1 of the Audit Commission annual return.</li> </ul>
<p>4 The accounting records in particular contain:</p> <ul style="list-style-type: none"> <li>• 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;</li> <li>• a record of the assets and liabilities of the body; and</li> <li>• a record of income and expenditure of the body in relation to claims made by them for contribution, grant or subsidy from the government.</li> </ul>	<ul style="list-style-type: none"> <li>• Day-to-day records (see Example 1)</li> <li>• Assets and liabilities register (see Example 2)</li> <li>• Grants register (see Example 3)</li> </ul> <p>Note – Examples may be found at the end of Part 3.</p>

<b>Statutory duty</b>	<b>Possible arrangements</b>
<p>5 The accounting control systems include:</p> <ul style="list-style-type: none"> <li>• 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;</li> <li>• identification of the duties of officers dealing with financial transactions and divisions of responsibilities of those officers in relation to significant transactions; and</li> <li>• procedures for uncollectible 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.</li> </ul>	<ul style="list-style-type: none"> <li>• 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.</li> <li>• Review systems at least annually or more frequently if required following any significant change of procedure or key personnel.</li> <li>• Add new systems if there is a business need to do so.</li> <li>• Report annually to the council prior to their completion of the annual return.</li> </ul>

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## **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 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.
- 3.16** 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**

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

## **Debts due to the council**

- 3.21** Effective debt collection is an essential part of proper financial management. Local councils 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.
- 3.22** Debt monitoring arrangements should be in place covering all activities of the council which involve receiving payment. For example, if the council rents out a number of allotments, a separate record may be appropriate for that purpose. The record would need to include details of the person who owes the debt, the amount, 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.
- 3.23** 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**

- 3.24** 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. 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).
- 3.25** 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 as an office-holder, the function of clerk to a local council in England can ever be self-employed.
- 3.26** 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**

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

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## **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	<p>In making estimates, most councils will start by looking at current year figures, with three main purposes:</p> <ul style="list-style-type: none"> <li>• 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);</li> <li>• to identify things that are happening in the current year that will not happen next year and do not need to be budgeted for again (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</li> <li>• 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).</li> </ul> <p>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.</p>
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 12 months.

<p>5 Bring together spending and income plans</p>	<p>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.</p> <p>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).</p> <p>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.</p>
<p>6 Provide for contingencies and consider the need for balances</p>	<p>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.</p>

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.

<p>7 Approve the budget</p>	<p>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.</p> <p>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.</p>
<p>8 Confirm the precept</p>	<p>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.</p> <p>All other parts of the budget process will be timed so that the date for setting the precept can be achieved safely.</p>

<p>9 Review progress against the budget</p>	<p>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.</p> <ul style="list-style-type: none"><li>• 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.</li><li>• 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.</li><li>• 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.</li></ul>
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## 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 minimus* 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.

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## 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).

<b>Bank Reconciliation</b>		
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 _____		
<b>Balance per bank statements as at 31 March 20XX</b>	<b>£</b>	<b>£</b>
eg Current account	1,000.00	
High interest account	3,000.00	
Building society premium a/c	10,000.00	
Petty cash float	10.00	
		14,010.10
Less: any un-presented cheques at 31 March (normally only current account)		
Cheque number 000154	(60.00)	
000157	(18.00)	
000158	(2.00)	(80.00)
Add any unbanked cash at 31 March		
eg Allotment rents banked 31 March (but not credited until 1 April)	50.00	50.00
<b>Net bank balances as at 31 March 20XX</b>		<b>13,980.00</b>
<b><i>The net balances reconcile to the Cash Book (receipts and payments account) for the year, as follows</i></b>		
<b>CASH BOOK</b>		
Opening Balance		15,280.00
Add: Receipts in the year		6,500.00
Less: Payments in the year		7,800.00
<b>Closing balance per cash book [receipts and payments book] as at 31 March 20XX (must equal net bank balances above)</b>		<b>13,980.00</b>

**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.

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## Preparing the Audit Commission annual return

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

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

**3.69** 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.

		<b>This year £</b>	<b>Last year £</b>	<b>Notes on compilation from Example 1 cash book</b>
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 investments	1,334		As line 7 – no other balances held but cash
9	Total fixed assets	NIL		
10	Total borrowings	NIL		

**For councils with gross income or expenditure (whichever is the higher) in any year between £200,000 and £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 12 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.

<p><b>Debtors:</b> 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.</p>	<p>To convert 'receipts' into 'income' take the cash book totals for receipts and:</p> <ul style="list-style-type: none"> <li>• <i>deduct</i> the amount of debtors brought into the calculation of income for the previous year; and</li> <li>• <i>add</i> the amount of debtors outstanding at the end of this year.</li> </ul>
<p><b>Receipts in advance:</b> situations where the council has received cash before the year-end, but has not yet provided the relevant goods and services by 31 March.</p>	<p>To convert 'receipts' into 'income' take the cash book totals for receipts and:</p> <ul style="list-style-type: none"> <li>• <i>add</i> the amount of receipts in advance excluded from the calculation of income for the previous year; and</li> <li>• <i>deduct</i> the amount of receipts in advance held at the end of this year.</li> </ul>
<p><b>Creditors:</b> 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.</p>	<p>To convert 'payments' into 'expenditure' take the cash book totals for payments and:</p> <ul style="list-style-type: none"> <li>• <i>deduct</i> the amount of creditors brought into the calculation of expenditure for the previous year; and</li> <li>• <i>add</i> the amount of creditors outstanding at the end of this year.</li> </ul>

<p><b>Prepayments:</b> situations where the council has paid cash before the year-end, but has not yet received the relevant goods or services by 31 March.</p>	<p>To convert 'payments' into 'expenditure' take the cash book totals for payments and:</p> <ul style="list-style-type: none"> <li>• <i>add</i> the amount of prepayments excluded from the calculation of expenditure for the previous year; and</li> <li>• <i>deduct</i> the amount of prepayments made at the end of this year.</li> </ul>
<p><b>Stock:</b> consumable goods (eg bar supplies) purchased before the end of the year but which have not been used by 31 March.</p>	<p>To adjust for stock in expenditure take the cash book totals for payments and:</p> <ul style="list-style-type: none"> <li>• <i>add</i> the amount of stock brought forward as an asset from the previous year; and</li> <li>• <i>deduct</i> the amount of stock held at the end of this year.</li> </ul>
<p><b>Provisions:</b> 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.)</p>	<p>To adjust for provisions in expenditure take the cash book totals for payments and:</p> <ul style="list-style-type: none"> <li>• <i>add</i> the value of any provision that needs to be made for events taking place in this year; and</li> <li>• <i>deduct</i> the value of any provisions made in previous financial years and brought forward, to this financial year and where payment has been made to settle the obligation and those no longer required.</li> </ul>

**3.79** Councils will need to have effective arrangements in place to identify and calculate the year-end 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	<p>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.</p> <p>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.</p> <p>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.</p>

4 (-) Staff costs	<p>This figure comprises all payments made in relation to the employment of staff. Include employment expenses which are benefits in kind (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.</p>
5 (-) Loan interest/capital repayments	<p>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.</p> <p>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.</p>
6 (-) Total other payments	<p>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.</p> <p>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.</p> <p>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.</p>
7 (=) Balances carried forward	<p>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.</p>

## 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	<ul style="list-style-type: none"> <li>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.</li> <li>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.</li> </ul>
Receipts in advance	<ul style="list-style-type: none"> <li>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.</li> <li>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.</li> </ul>
Creditors	<ul style="list-style-type: none"> <li>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.</li> <li>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.</li> </ul>

Prepayments	<ul style="list-style-type: none"> <li>• 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.</li> <li>• 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.</li> </ul>
Stock	<ul style="list-style-type: none"> <li>• 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</li> </ul>
Provisions	<ul style="list-style-type: none"> <li>• 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.</li> <li>• 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.</li> </ul>

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

		<b>R + P</b> £	<b>Previous year</b> <b>adjustments</b> £	<b>Current year</b> <b>adjustments</b> £	<b>I + E</b> £	<b>Notes on compilation from the receipts and payments account</b>
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.

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

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	<p>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.</p> <p>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.</p>
9 Total fixed assets and long-term investments	<p>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).</p> <p>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.</p>

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.
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- 3.86** The annual return requires supporting documentation for the accounting statements in section 1 to be provided to the auditor. Because of its importance as confirmation that the council's books of accounts are supported by the bank's records, the most important document to be provided is the year-end bank reconciliation. The reconciliation should be prepared to at least the 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).

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## **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 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: <ul style="list-style-type: none"> <li>• requesting bank statements for 31 March for all bank accounts;</li> <li>• arranging for savings account books to be made up to date for 31 March; and</li> <li>• obtaining written confirmation of loans and investments at 31 March, including interest for the year.</li> </ul>
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 accounting statements 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 annual return.
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	<p>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:</p> <ul style="list-style-type: none"> <li>• the dates of the 20 working day period during which the accounts and other documents will be available for</li> <li>• inspection;</li> <li>• the place at which, and the hours during which, they will be available;</li> <li>• the name and address of the auditor;</li> <li>• the rights conferred on the public by sections 14 and 15 of the Act (public inspection of accounts and right to challenge); and</li> <li>• the appointed date for audit.</li> </ul> <p>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 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.</p>

Step	Task	Comments
6	Submit the completed annual return to the council for approval	<p>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.</p> <p>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.</p> <p>If a Council is unable to approve the accounts by 30 June then, according to regulation 10(6) it must:</p> <p>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.</p>

Step	Task	Comments
7	Make the accounting statements and other documents available for inspection	<p>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.</p> <p>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.</p> <p>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.</p> <p>The inspection period has to be completed before the auditor's appointed date for audit.</p>
8	The audit	<p>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.</p> <p>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.</p> <p>The Audit Commission provides guidance to external auditors. This may be viewed at Appendix 5.</p>

Step	Task	Comments
9	Publish the accounting statements	<p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p>

Step	Task	Comments
10	At the conclusion of the audit, display a notice of public rights	<p>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 annual return (sections 1 to 3) is available for inspection. The annual return that is made available (not the notice itself) must:</p> <ul style="list-style-type: none"> <li>• contain any amendments required by the auditor's report (or a statement of the amendments that were required);</li> <li>• if auditor's amendments have been made, be accompanied by an explanation as to the material respects in which the accounting statements have been altered;</li> <li>• contain a statement of the rights of local electors under section 14 of the Audit Commission Act 1998 to inspect and copy the annual return and auditor's reports; and</li> <li>• state the address at which and the hours during which the annual return and auditor's reports are available for the exercise of these rights.</li> </ul>

## Example 1 Cash Book layout

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

					Receipts			Payments				Vat Transactions		
31 May	Grant from Sports Council	17	100.00				100.00							
	Sub-totals for this period		1,110.37	784.99	400.00	600.00	100.00	200.00	32.08	250.00	268.27	34.64	-	34.64
		totals	2,119.12	784.99										
31 May	balance carried forward			1,334.13										
			2,119.12	2,119.12										
1 June	balance brought forward		1,334.13											

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

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## Example 2 Schedule of Assets

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

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## **Notes**

**3.101** 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).

**3.102** 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**

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

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# Part 4 – Accounting guidance for local councils in England with income or expenditure exceeding £1 million ('larger local councils')

From financial year 2009/10 larger 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 Financial Reporting Standard for Smaller Entities ('the FRSSE') which is issued by the Accounting Standards Board.

Larger local 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 FRSSE from year two onwards.

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

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## Background

- 4.1 This accounting guidance is designed to assist larger local councils to prepare a statement of accounts with due regard to 'proper practices', that is, the relevant professional standards which, given the scale of larger local councils' activities, are applicable.
- 4.2 Local councils, governed by the Local Government Acts and with a turnover in excess of £1 million per annum, are 'relevant bodies' according to Regulation 2(1) of the Accounts and Audit Regulations 2003 (as amended) issued under section 27 of the Audit Commission Act 1998 ('the regulations'). They are referred to within this guidance as 'larger local councils'.

- 4.3 The regulations require<sup>I</sup> all relevant bodies ‘to prepare, in accordance with proper practices in relation to accounts, a statement of accounts each year...’ Guidance<sup>II</sup> issued by the Department for Communities and Local Government (CLG) in support of the regulations confirms that proper practices in relation to accounts for local councils may be found in this Practitioners’ Guide or in the Statement of Recommended Practice issued by CIPFA (‘The SoRP’).
- 4.4 However, from 2009/10 CIPFA disapplied the SoRP for larger local councils adopting the proper accounting practices presented here and so the SoRP no longer applies to the preparation of annual statements of accounts for larger local councils in England.
- 4.5 For financial year commencing on 1 April 2009 and thereafter, the ‘proper practices in relation to accounts’ guiding larger local councils in the preparation of the annual statements of accounts are found in Part 4 of Governance and Accountability for Local Councils: A Practitioners’ Guide 2010 (England) and its successor publications (‘the guidance’).
- 4.6 This guidance is part of the ‘proper accounting practices’ requirements governing the preparation of larger local councils’ Statements of Accounts referred to in section 21 of the Local Government Act 2003<sup>III</sup>. All authorities to which section 21 applies that are required to prepare a Statement of Accounts by the regulations have a statutory duty to comply with these proper practices.
- 4.7 By following the provisions of the Accounting Standards Board’s Financial Reporting Standard for Smaller Entities effective April 2008 (‘the FRSSE ’)<sup>IV</sup> and its successor publications, larger local councils meet the statutory requirement to follow accepted proper practices.
- 4.8 Larger local councils should follow the provisions of the FRSSE as presented herein. The guidance in this Part should be applied to all accounting periods commencing on or after 1 April 2009. Local councils operating below the £1 million annual turnover threshold (‘small local councils’) continue to complete an annual return and are not required to prepare and submit accounts in accordance with this Part 4.
- 4.9 By adopting and applying the FRSSE, larger local councils become exempt from applying more complex accounting standards such as Statements of Recommended Accounting Practice (SoRP), other Financial Reporting Standards (FRS including IFRS) and Urgent Issues Task Force (UITF) Abstracts.
- 4.10 This guidance is designed to advise larger local councils on the application of the FRSSE to their financial statements taking into account their statutory functions.
- 4.11 This guidance takes precedence over the requirements of the FRSSE. However, in the event of ambiguity in the guidance, its meaning should be read as being consistent with the FRSSE, subsequent amendments or successor publications.

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<sup>I</sup> Regulation 7 of the Accounts and Audit Regulations 2003 (as amended – see Appendix 7)

<sup>II</sup> CLG Circular 03/2006 – see Appendix 7

<sup>III</sup> See Schedule 1 below

<sup>IV</sup> Available from <http://www.frc.org.uk/asb/technical/frsse.cfm>

4.12 In the event of conflict between this guidance including the FRSSE and statutory requirement, the statutory requirement shall represent the proper practices to be applied.

4.13 Section 4.1 below covers general principles and accounting concepts for the accounts.

4.14 Section 4.2 describes the statements of accounts in greater detail and the form of their presentation.

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### **Transitional arrangements**

4.15 In the first year of reporting under FRSSE those councils formerly reporting under the CIPFA SoRP should adopt the following general approach:

- Within the statement of accounting policies, councils must make clear that the current year's accounts have been prepared for the first time following FRSSE and Part 4 of the Practitioners' Guide
- The statement must include quantified details of the effect of any changes in accounting policies in accordance with the requirements of paragraph 4.28 below. Any required changes to opening balances should be accounted for as a Prior Period Adjustment in accordance with directions in paragraph 2.15 of the FRSSE.
- Any Capital Adjustment Account (SoRP requirement) should be renamed the Capital Financing Account.
- If a council exercises the option to retain the closing book values of tangible fixed assets as described in paragraph 4.39 below, it must accumulate any balance shown on the former Revaluation Reserve into the opening balance of the new Capital Financing Account and make the appropriate disclosures.
- Further guidance on transitional matters may be found at the appropriate sections below.

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# Section 4.1 – General requirements and accounting principles

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## The structure of the accounts

4.16 Local councils that exceed the turnover threshold should follow the FRSSE. When preparing their financial statements practitioners must recognise that not all of the elements apply to larger local councils given their statutory framework, powers, duties and functions.

4.17 The financial statements subject to audit should consist of the following:

- an annual report;<sup>v</sup>
- an annual governance statement;
- a statement of responsibilities for the statement of accounts;
- a statement of accounting policies;
- an income and expenditure account;
- a statement of movement of reserves;
- a statement of total recognised gains and losses;<sup>vi</sup>
- a balance sheet;
- notes to the accounts including disclosures required by statute; and
- the external auditor's report.

4.18 The regulations require a statement of internal control, prepared in accordance with proper practices, to be included with the financial statements. This requirement is met by including the annual governance statement with the financial statements. Departmental guidance<sup>vii</sup> identifies this Practitioners' Guide as the source of appropriate professional guidance on proper practice in relation to internal control, details of which may be found above in Part 2 of this Practitioners' Guide.

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<sup>v</sup> The annual report is not covered by the auditor's certificate. However, financial information contained in the annual report must be consistent with the financial statements and notes.

<sup>vi</sup> Only required if gains and losses are not recognised in the I&E account. For example those which may occur if the council adopts an accounting policy of revaluation of assets)

<sup>vii</sup> DCLG Circular 03/2006 – see Appendix 7

- 4.19 A large local council should add such additional information or statements as are necessary to ensure a true and fair view of its financial position and transactions is presented. The FRSSE requires a Director's Report to accompany the statement of accounts. In order to meet this requirement, larger local councils should provide an annual report on its activities during the reporting year which is approved by the council.
- 4.20 The annual report should include such additional information to enable the user of the accounts to gain a better understanding of any matters set out in the accounts. Practitioners should note the external auditor's opinion does not cover the annual report. Auditors will, however, check that it meets minimum disclosure requirements and for consistency between financial information presented in the annual report and within the council's financial statements.
- 4.21 The FRSSE while recommending the voluntary disclosure of cash flow information states that this is not a mandatory requirement.
- 4.22 All accounts and notes, including the cash flow statement if reported, should present both current and preceding accounting period information.
- 4.23 Although not a requirement of the FRSSE, where a council is the sole managing trustee for a trust fund, including charitable trusts, a separate trust fund revenue account and balance sheet should be disclosed by means of a note to the financial statements.
- 4.24 Larger local councils should use discretion in providing additional information over and above that required by proper practice that may be of interest to the users of the accounts, for example, if the council runs leisure or cultural services, car parks etc. Such information must be provided separately from the accounting statements, preferably within the annual report, and clearly excluded from those statements that are subject to the auditor's opinion and report.
- 4.25 Larger local councils should note however that if additional information is published with the financial statements it will be reviewed by the auditor in the same way as the annual report to check consistency with the audited financial statements.

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## **Accounting Principles and Policies**

- 4.26 The financial statements should state that they have been prepared in accordance with the FRSSE and this guidance and should include:
- a description of each material accounting policy (see below);
  - a statement (if necessary) detailing any changes to the accounting policies from one period to another, including reasons for change and an analysis of the financial effect of the change; and
  - where the effect of a change to an estimation technique is material, a description of the change and where practicable the effect on the result for the current period.

4.27 When preparing the financial statements local councils should have regard to the following accounting principles:

- **Going Concern:** Local councils carry out their functions as a going concern. Any material uncertainties about this presumption are disclosed.
- **Prudence:** Local councils determine any amount of any item on a prudent basis. That is to exercise a degree of caution when making estimates under conditions of uncertainty so that assets are not overstated and liabilities not understated.
- **Accruals:** The financial statements are prepared on an accruals basis. All income and expenditure relating to the financial period to which the accounts relate is taken into account without regard to the date of payment or receipt.
- **Relevance:** The financial statements provide information about the council's financial performance that is useful for assessing the stewardship of public funds and for making economic decisions.
- **Consistency:** Consistent accounting policies are applied both within the accounting period and between accounting periods. Where accounting policies are changed, the reason and effect are separately disclosed.
- **Reliability:** The financial information provided is reliable and:
  - reflects the substance of the transactions and other events that have taken place;
  - is free from deliberate or systematic bias;
  - is free from material error;
  - is complete within the bounds of materiality; and
  - under conditions of uncertainty, is prudently prepared.
- **Comparability:** The financial statements are prepared with consistent and adequate disclosure to allow comparability.
- **Understandability:** All reasonable efforts are taken in preparing financial statements to ensure they are as easy to understand as possible.
- **Materiality:** An item of information is material if its mis-statement or omission might reasonably be expected to influence assessments of stewardship and economic decisions, or comparisons with other entities, based upon the financial statements.

4.28 Accounting policies and estimation techniques shall be consistent with the FRSSE and applied consistently within the same financial statement and from one financial period to the next. If there is a material change in accounting policy the amounts for the current and corresponding periods shall be restated on the basis of the new policies by making prior period adjustments.

4.29 Prior period adjustments shall be made by restating the comparative figures for the preceding year and adjusting the opening balances of reserves accordingly. Where a statement of total recognised gains and losses has been prepared the cumulative amount should also be noted at the foot of the current period.

## Accounting for Grants

- 4.30 Revenue grants and subsidies should be credited to revenue accounts and accrual is only made for amounts known to be receivable at the end of the accounting period.
- 4.31 A government grant should not be taken to the income and expenditure account unless the conditions for its receipt have been met and there is reasonable assurance that it will be received.
- 4.32 Where the acquisition of a fixed asset is financed either wholly or in part by a government grant or other contribution, the amount of the grant or contribution should be deducted from the purchase price of the asset.
- 4.33 Larger local councils previously adopting a policy of deferring grants which are then amortised over the useful life of the related asset by taking annual contributions to revenue may:
- apply any unamortized grant balance against the depreciated value of the asset and depreciate the adjusted asset value over the remaining life of the asset, restating the opening balances accordingly; or
  - continue with a policy of depreciating the gross value of the asset and releasing the associated capital grant as previously. Councils opting for this approach must make full disclosure in their accounting policies and identify in a note to the balance sheet any assets and grants subject to this treatment.
- 4.34 Where a large local council elects to continue with a policy of deferring government grants received and proportionally releasing the capital grant over the lifetime of the associated asset to offset the impact of depreciation, an additional year-end journal is required as follows to neutralise distortions:
- Debit – Reversal of government grant amortisation (I&E)
- Credit – Capital Financing Account

## Fixed Assets

- 4.35 The FRSSE requires that expenditure on tangible fixed assets shall be measured at cost and then written down to its recoverable amount if necessary. Assets are defined as rights or other access to future economic benefit controlled by a local council as a result of past transactions or events. Other than for investment property, the option of revaluing assets, although permitted by the FRSSE, is not recommended.
- 4.36 All expenditure on the acquisition, creation or enhancement<sup>viii</sup> of fixed assets above a de minimus level should be recognised on a consistent basis and capitalised on an accruals basis in the accounts. Councils must set an appropriate de minimus level for each category of asset and review this level from time to time.

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<sup>viii</sup> Not all subsequent expenditure on assets is capital expenditure. Practitioners are directed to paragraph 6.22 of the FRSSE 2008 which describes the only conditions under which subsequent expenditure may be capitalised and thus qualify as capital expenditure.

**4.37**The FRSSE provides for fixed assets to be classified as between:

- research and development, intangible assets and goodwill;
- tangible fixed assets; and
- investments (in companies) and investment properties.

**4.38**Councils are likely to own only tangible fixed assets (land and buildings, vehicle and plant) and some may also hold investment properties. No further specific sub-division into type of fixed assets is required by the FRSSE. However if larger local councils consider that users of the financial statements should be provided with further information, a

sub-division of tangible fixed assets between land and buildings; vehicles and plant; and non-operational assets by way of a note to the accounts is suggested.

**4.39**Tangible fixed assets should be recorded at historic cost and written down to a recoverable amount if less. In the event of the rare occurrence where historic cost is not known, the book value of an asset may be estimated by the Members of the council on the basis of professional guidance. Assets valued in this way must be individually identified in asset registers and in the notes to the accounts.

**4.40**For the first accounting period under the FRSSE, if a larger local council does not adopt an accounting policy of revaluation of tangible fixed assets but the carrying amount of its tangible fixed assets reflects previous revaluations and impairment it may:

- retain the book amounts. In these circumstances the council shall disclose the fact that the transitional provisions in paragraph 19.3 of the FRSSE are being followed and that the valuation has not been updated and give the date of the last valuation; or
- restate the carrying amount of the tangible fixed assets to historical cost (less restated accumulated depreciation) as a change in accounting policy.

**4.41**Where a larger local council elects to continue with an accounting policy of carrying tangible fixed assets at valuation, the Income and Expenditure account named 'Reversal of annual depreciation charge' must be renamed 'Reversal of annual depreciation charge and impairments'.

**4.42**Under an accounting policy of carrying tangible fixed assets at valuation two year-end adjustments are required:

- whenever an impairment is charged to the Income and Expenditure account, the impact on council tax must be neutralised by a year-end journal adjustment as follows:

Debit – Capital Financing Reserve (with the value of the impairment)

Credit – Reversal of annual depreciation charge and impairments

- An annual adjustment to the Revaluation Reserve is required in respect of the difference between the actual depreciation charge (on revalued assets) and the historical cost depreciation as follows:

Debit – Revaluation reserve (with the difference between historical and current cost depreciation)

Credit – Capital Financing Reserve

**4.43** Where a larger local council disposes of an asset for a value above the de minimus level (as set out in its accounting policies), the proceeds of which are a capital receipt within the meaning of the Local Authorities (Capital Financing and Accounting) (England) Regulations 2003, any gain or loss falls to be reported in the Income and Expenditure Account. However, the gain or loss must be reversed out of the General Fund in a year-end journal as follows:

Debit – Reversal of gains and losses on capital transactions (proceeds of sale)

Credit – Usable Capital Receipts Reserve (with proceeds of sale)

Debit – Capital Financing Account (carrying value of disposed asset)

Credit – Reversal of gains and losses on capital transactions (with carrying value of disposed asset)

**4.44** Where a larger local council acquires tangible fixed assets that are funded in whole or in part from Usable Capital Receipts this must be reported as follows:

- A year-end journal:

Debit – Usable Capital Receipts Reserve (use of capital receipts)

Credit – Capital Financing Account (with value of funding from capital receipts); and

- The adjustment is reported in the Statement of Movements in Reserves

### **Investments**

**4.45** Where held, investments should be disclosed in the balance sheet at historic cost. The market value of investments at the balance sheet date should be disclosed in a note to the accounts supported by an investments register. Realised gains are taken to the income and expenditure account as they occur. Provision should be made for any diminution in value of investments.

**4.46** Where investment properties are held, these must be disclosed on the balance sheet within Fixed Assets at market valuations. Because of the inherent risk of such investments for local councils, investment property valuations must be made at frequent intervals, at least annually.

## Depreciation

- 4.47** All tangible fixed assets (other than investment properties) should be depreciated over their useful economic life on an appropriate basis. Land is regarded as having an unlimited useful economic life and is therefore not depreciated. Investment properties are not depreciated except where held on a lease with an unexpired term of 20 years or less.
- 4.48** The notes to the accounts and the asset register should disclose the depreciation method applied and the useful economic lives of the assets.
- 4.49** For fixed assets other than non-depreciable land and non-operational investment properties, the only ground for not charging depreciation is that the depreciation charge is immaterial.
- 4.50** For simplicity, it is suggested that depreciation is provided by the straight line method so as to write off the cost of the relevant assets in equal instalments over their useful economic lives. However larger local councils should consider whether other more appropriate methods should be adopted depending on their circumstances. Any changes to depreciation methods or periods must be disclosed in the accounting policies and highlighted in notes in the year of change.
- 4.51** Depreciation should be charged to the income and expenditure account and reported within 'other costs' under the Democratic, Management and Civic Costs heading.
- 4.52** However, larger local councils must also meet the requirement contained in paragraph 3 of Schedule 1 to the Local Government Act 2003<sup>ix</sup>. This requires that where a larger local council meets any expenditure by borrowing, it shall in each financial year debit the 'appropriate amount' to the account from which that expenditure would otherwise fall to be met.
- 4.53** The 'appropriate amount' is a sum equivalent to an instalment of principal and interest combined such that if paid annually it would secure the payment of interest at the due rate on the outstanding principal together with the repayment of the principal not later than the end of the fixed period. The appropriate amount should be debited to the Income and Expenditure account with an offsetting credit to the Capital Financing account.
- 4.54** The effect of the statutory requirement is that the council's income and expenditure account will be debited each year with actual depreciation and any annual loan interest charges as well as the statutory cost of an annual instalment of debt plus interest within the 'appropriate amount'. Therefore, in order that taxpayers are not affected by this double charge to the precept, larger local councils must make the necessary adjustments to their financial statements.

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<sup>ix</sup> Schedule 1 to this guidance below reproduces this statutory requirement in full.

4.55 In order to reach an accurate Net Surplus or Deficit for the Year larger local councils must each year reverse out from the income and expenditure account:

- the annual depreciation charge; and
- any actual loan interest paid.

4.56 These amounts should be credited to the Income and Expenditure account and debited to the Capital Financing Account, which will show the net cumulative effect of these offsetting adjustments. The annual reversal of depreciation is required whether the council borrows or not.

4.57 Practitioners are reminded that the duty to make a minimum revenue provision (MRP) contained in Regulation 27(1) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 does not apply to any parish council.

### **Leasing**

4.58 Leases take two forms. Finance leases are leases where substantially all of the risks of ownership are transferred to the council, Operating leases are defined as any lease that is not a finance lease. If, at the inception of a lease, the present value of the minimum lease payments, including an initial payment, amounts to substantially all (ie normally 90 per cent or more) of the fair value of the asset subject to lease, it is presumed to be an operating lease.

4.59 A finance lease should be recognised on the balance sheet as an asset and also as an obligation to pay future rentals. At the inception of the lease the sum to be recorded both as an asset and a liability shall normally be the fair value of the asset. An asset held under a finance lease should be depreciated over the shorter of the lease term and its useful life.

4.60 The finance charge under a finance lease should be allocated to each accounting period over the lease term and a straight line method is reasonable,

4.61 Operating lease rentals should be charged to revenue on a straight line basis over the lease term whether or not this matches actual payments.

4.62 Hire purchase contracts which have the characteristics of a finance lease should be accounted for as a finance lease. Other hire purchase contracts should be treated as operating leases.

### **Stock and Work In Progress (WIP)**

4.63 Stock and WIP should be included at the lower of cost or net realisable value.

### **Short Term Investments**

4.64 Investments which will or may mature during the following financial year should be included in the balance sheet at the lower of cost or net realisable value.

## **Debtors**

4.65 Debtors should be stated net of a provision for bad and doubtful debts where one is necessary. The note to the accounts should analyse debtors (with previous accounting period comparatives) analysed as to amounts falling due within one year and over one year. The following subdivision is suggested:

Trading debtor amounts falling due under one year

Trading debtor amounts falling due after one year

Sundry Debtors

(Less: Provision for bad and doubtful debts)

= Subtotal Trading and Sundry Debtors

HM Revenue and Customs (VAT)

Cash with Officers

## **Cash at Bank and In Hand**

4.66 Cash at bank should include current and deposit accounts at banks and building societies. Cash in hand is the value of all petty cash floats.

## **Creditors**

4.67 Trading creditors and the value of HM Revenue and Customs creditor should be identified in the supporting note, with VAT and payroll deductions (Income Tax, Employees and Employers NI) amounts due separately disclosed.

4.68 Amounts received by way of development contributions that are held on a conditional basis and may be repayable if not used for the purpose provided are not to be treated as reserves, but accounted as receipts in advance and included with creditors.

## **Other short term liabilities**

4.69 Short term liabilities should include the current portion of long term debt – the capital amount of loans outstanding repayable within the next financial year.

## **Long Term Liabilities**

4.70 Long Term Borrowing: for those local councils that have taken out loans to finance capital expenditure a note to the accounts showing the nature of the borrowing and an analysis of the maturity profile is required. For ease of reading this may be presented in a table within the note identifying borrowing due to be repaid within one year, one to two years, two to five years and over ten years. The current portion of long term debt should be shown as a current liability.

## **Reserves**

- 4.71** Reserves are the net worth of the council at the accounting date. Reserves should only include amounts held by the council as development contributions where such contributions are unconditional.
- 4.72** The disclosure of reserves reflects the historic financial position as at the end of the accounting period. Further analysis by local councils into designated or undesignated reserves is entirely optional and should only be presented as note to the accounts.
- 4.73** The Capital Financing Account is a non-distributable reserve used to hold the adjusting balances between annual depreciation and the statutory annual 'appropriate charge' for borrowing and for other capital transactions identified within this guidance.

## **Pensions**

- 4.74** Section 10 of the FRSSE covers the accounting requirements for entities operating either direct contributions or defined benefits pension schemes and deals with matters of recognition, valuation and presentation as well as measurement. Employees of larger local councils are usually members of the Local Government Pensions Scheme, a statutory scheme, which provides members with defined benefits (retirement lump sums and pensions) related to pay and service. As such larger local councils should account for their employees' retirement benefits on that basis.
- 4.75** However, although the Local Government Pensions Scheme (LGPS) is a defined benefits scheme, it may not always be possible to identify clearly and specifically the share of the underlying assets and liabilities of the particular scheme that relate to a larger local council's employees. It may therefore not be possible to determine a fair value of the scheme attributable to the Council's employees. This would occur, for example, where the scheme actuary groups a number of smaller admitted bodies together and determines a common contribution rate.
- 4.76** If a fair valuation is not possible, larger local councils should account for pensions on a defined contributions basis (see below).
- 4.77** Where a fair valuation is possible, larger local councils should follow the requirements of section 10 of the FRSSE and Appendix 2.
- 4.78** Councils are expected to obtain the best information available in relation to meeting accounting standards. The cost of obtaining information is not a barrier. Wherever information is available from a scheme actuary accurately valuing the council's share of the pension scheme assets and liabilities, then this information must be applied in the preparation of the financial statements. Guidance on the requirements for reporting defined benefits schemes is found in FRSSE Appendix 2 and is subject to this guidance.

4.79 Larger local councils following the requirements of FRSSE Appendix 2 must charge to the income and expenditure account an amount equal to the retirement benefits payments and contributions to pension funds which are payable for that year in accordance with statutory requirements<sup>x</sup>.

4.80 However, in order to also meet the statutory requirement to neutralise the impact on the council tax of charges included in the accounts to meet accounting standards, a larger local council participating in a defined benefits pension scheme for which its share of the assets and liabilities can be identified must:

- Include a **Pensions Reserve** line in the Reserves section of the balance sheet;
- Include an additional line in the Income and Expenditure account (between the Net Operating Surplus/Deficit for the Year and the Net Surplus/Deficit for the Year (to General Fund)) described as **Pension Fund Adjustment**; and
- Make a year-end journal adjustment to reverse out of the Income and Expenditure account any amounts charged in respect of the pension fund in accordance with the FRSSE (current service costs, past service costs, settlements, interest costs and expected return on assets) and replace them with the contributions payable by the council for the year as follows:
  - *Amounts included in the Income and Expenditure account (ie current service costs, past service costs, settlements, interest costs and expected return on assets)*
  - Debit – Pension Reserve
  - Credit – Pension Fund Adjustment
  - *Contributions Payable*
  - Debit – Pensions Fund Adjustment
  - Credit – Pensions Reserve

4.81 The cost of a defined contribution scheme (or of a defined benefits scheme where a fair valuation is not possible) is equal to the contributions payable to the scheme for the accounting period and should be recognised in the income and expenditure account. In addition, the following disclosures should be made in a note to the Income and expenditure account:

- the nature of the scheme;
- the cost for the period; and
- any outstanding or prepaid contributions at the balance sheet date.

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<sup>x</sup> The Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 and The Local Government (Early Termination of Employment) (Discretionary Compensation)(England and Wales) Regulations 2000 or the Local Government (Early termination of Employment) (Discretionary Compensation) (England and Wales) Regulations 2006

### **Post Balance Sheet Events**

- 4.82** Post balance sheet events whether favourable or unfavourable are identified as either adjusting or non adjusting events. Adjusting events those that provide evidence of conditions that existed at the balance sheet date. Non-adjusting events are those that are indicative of conditions that arose after the balance sheet date.
- 4.83** Councils should adjust the amounts recognised in the accounts to reflect adjusting events after the balance sheet date.
- 4.84** Councils should not adjust the accounts for non adjusting events after the balance sheet date. However if the event is material it should be disclosed by way of a note identifying the nature of the event and an estimate of its financial effect if it can be made, or a statement otherwise.

### **Related Party Transactions**

- 4.85** Two or more parties are related if at any time during the accounting period:
- one party has a direct or indirect control of the other party; or
  - the parties are subject to common control from the same source; or
  - one party has significant influence over the financial and operating policies of the other party.
- 4.86** Where a council purchases, sells, transfers goods and other assets or liabilities, renders or receives services or provides or receives financial support to or from a related party of a material nature such transactions must be disclosed. Transactions with members of the council or with companies controlled by them should be disclosed.
- 4.87** Disclosure of pension contributions and employees salaries, transactions with utility companies and government departments and agencies are not required to be reported as related party transactions.

### **Signing and Approval of the Accounts**

- 4.88** The financial statements should be prepared in accordance with Regulation 10 of the Accounts and Audit Regulations 2003 as amended and be signed and certified by the responsible financial officer and submitted for approval by the council, or by a committee appointed for this purpose, in accordance with the regulations.

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# Section 4.2 – Financial statements in detail

## General Disclosure Requirements

**4.89** The financial statements should state that they have been prepared on the basis of the applicable sections of the FRSSE and this guidance. Any departure from the guidance in order to present a true and fair view should be disclosed and the reasons for the departure identified together with an explanation of how the position shown in the financial statements is different as a result of the departure.

**4.90** The financial statements shall include:

- a description of each material accounting policy followed;
- details of any changes to the accounting policies followed in the proceeding period, and in addition to the disclosures necessary for prior period adjustment, a brief explanation of why each accounting policy is more appropriate and where practicable an indication of the effect on the current accounting period;
- where the effect of a change to an estimation technique is material, a description of the change and where practicable a indication of the effect on the results of the current accounting period;
- disclosure of any material uncertainties as to the going concern presumption should be disclosed; and
- comparative amounts from previous accounting periods for every item disclosed in the balance sheet, income and expenditure accounts, other financial statements and notes to the financial statements, with the exception of details of additions and disposals etc of fixed assets and their cumulative depreciation.

## Annual Report

**4.91** The FRSSE requires the inclusion an annual report, referred to in the FRSSE as the directors' report. This formal annual report is not the document referred to in the Quality Parish Council Scheme. It is a useful means of presenting detailed financial information in the context of the council's operating environment.

**4.92** The annual report is not subject to detailed audit review although auditors will report by exception any inconsistency with the council's financial statements. Preparers of financial statements should ensure that there is internal consistency throughout prior to presenting them to the council for approval. The annual report should be approved by the full council and signed by the Chair accordingly.

**4.93** The annual report should be an easily understandable guide to the most significant matters reported in the financial statements. It should provide an explanation in overall terms of the council's financial position, and assist in the interpretation of the financial statements. It should also contain a commentary on the principal activities of the council, the major influences affecting the council's income and expenditure during the year and information on the financial needs and resources of the council.

**4.94** Where one is prepared, the FRSSE requires the following disclosures to be included in the annual report:

- a description of the principal activities of the council;
- details of the Members of the Council; and
- a statement describing the policy adopted in relation to disabled people (only required if over 250 employees).

**4.95** The annual report should be concise and restricted to significant matters. It should include such items that are likely to be significant to the understanding of the accounts such as:

- an explanation of which financial statements follow, their purpose and the relationship between them;
- a comparison of expenditure in the year with the original budget for the accounting period, and an explanation of significant variations from it;
- a brief note of any major fixed asset acquisitions and disposals or material liabilities incurred;
- an explanation of any material and unusual charge or credit in the accounts;
- any significant change in accounting policies. The reason for the change, and the effect on the accounts, should be explained;
- any major change in statutory functions which has a significant impact on the financial statements. In addition, a comment on planned future developments in service delivery, including a summary of revenue and capital investment plans, distinguishing between expenditure intended to maintain existing levels of service provision and that intended to expand existing services or develop new services;
- a brief note of the council's current borrowing, outlining the purpose and impact of financing transactions entered into during the year; and
- a summary of the council's internal and external sources of funds available to meet its capital expenditure plans and other financial commitments.

## **Annual Governance Statement**

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

**4.97** Part 2 of this guidance is recognised by Government as a source of proper practice and requires the production of an annual governance statement. Therefore the statements of accounts should include the annual governance statement. The annual governance statement should contain:

- an acknowledgement of council's responsibility for ensuring there is a sound system of internal control;
- an indication of the level of assurance that a system of internal control can provide;
- a brief description of the key elements of the internal control environment;
- a brief description of the process that has been applied in maintaining and reviewing the effectiveness of the system of internal control, including some comment on the role of the council and any committee charged with an overview of the council's governance arrangements, internal audit and any other assurance mechanisms; and
- an outline of the actions taken, or proposed, to deal with significant internal control issues.

**4.98** The annual governance statement should be signed by the chair of the Council and the chief executive officer or clerk of the Council. The minimum amount of disclosure required in the annual governance statement is the same as that contained in the annual return used by smaller local councils (see Part 2 of this guidance above). Larger local councils may wish to apply the guidance contained in the joint CIPFA/SOLACE framework – Delivering Good Governance in Local Government.

## **The Statement of Responsibilities for the Accounts**

**4.99** The statement of responsibilities should:

- acknowledge the council's responsibilities for the proper administration of its financial affairs and the appointment of a responsible financial officer (RFO);
- acknowledge the council is required to manage its affairs to secure economic, efficient and effective use of its resources;
- set out the RFO's responsibilities for the preparation of the accounts, the selection and application of appropriate accounting policies, for estimation techniques and compliance with generally accepted accounting practice, the maintenance of proper records and steps taken to prevent and detect irregularities; and
- be signed and dated by the responsible finance officer.

## **Statement of Accounting Policies and Estimation Techniques**

**4.100** The statement should include the following:

- an acknowledgement that the accounts have been prepared in accordance with proper accounting practices and this guidance;
- the fundamental accounting concepts and estimation techniques used in the preparation of the statement of accounts (accruals, relevance, consistency, reliability, comparability, understandability, materiality, and going concern);
- for fixed assets, the basis of recognition, initial measurement, valuation, depreciation and disposal of each class of tangible fixed assets;
- the accrual of income and expenditure;
- the treatment of contingent liabilities and contingent assets;
- the basis on which stocks are included in the accounts;
- the accounting treatment for capital receipts;
- the accounting treatment for grants and contributions;
- the accounting treatment for leases and other similar instruments;
- the recognition and treatment of provisions and other liabilities;
- the recognition and treatment of balances and earmarked and general reserves;
- the accounting treatment for pensions;
- the reporting of contingent liabilities and contingent assets
- the accounting treatment for post balance sheet events;
- exceptional items, extraordinary items and prior period adjustments; and
- the accounting treatment of acquired or discontinued operations.

**4.101** If other material accounting policies are adopted and applied these should also be fully disclosed here.

## **The Income and Expenditure Account**

- 4.102 The income and expenditure account should include information for both current and prior year accounting periods.
- 4.103 Revenue arises from precepts, grants, rents, interest and other investment income, delivering services and sundry statutory function activities.
- 4.104 It is recommended that the analysis of income and expenditure should contain a summary of the main fund raising and spending areas shown below:

### **Income**

- Precept
- Grants received
- Rental income, interest and investment income
- Charges made for services
- Other income or contributions

### **Expenditure**

#### *Direct Service Costs:*

- Salaries and Wages
- Grant-aid expenditure
- Other direct service costs

#### *Democratic, Management and Civic Costs:*

- Salaries and Wages
- Other Democratic, Management and Civic costs

### **Exceptional Items (if any)**

- Gains or losses on disposal of fixed assets

### **Net Operating Surplus or Deficit for Year**

- Statutory charge for capital ('the appropriate amount') (Debit)
- Revenue expenditure funded from capital under statute (REFCUS)
- Reversal of annual depreciation charge [and impairments] (usually a Credit)
- [Reversal of gains and losses on capital transactions]
- [Reversal of government grant amortisation]

### **Net Surplus or Deficit for Year (to General Fund)**

## Disclosure Notes to the I&E Accounts

- 1 An analysis of grants received. Grants may be received from other local authorities. The nature and the amount of grants received should be identified where material.
- 2 Information about the Pension Scheme offered to employees identifying the administering authority, the nature of the scheme, the cost for the period and the amount of any outstanding or prepaid contributions at the balance sheet date.
- 3 Disclosure of remuneration of staff earning over £50,000 per annum in bands of £10,000 with current year and previous year numbers of employees<sup>XI</sup>.
- 4 Audit fees and expenses
- 5 Related party transactions: Councils should disclose related party transactions that are material to the Council's accounts including:
  - the name of related parties;
  - a description of the relationship;
  - the amounts involved;
  - any other elements of the transaction necessary for an understanding of the financial statements;
  - the amounts due to or from related parties at the balance sheet date and any provisions for doubtful debts at that date, and
  - any amounts written off in the accounting period in respect of debts due from related parties.
- 6 Details of adjustment for depreciation and calculation of the 'appropriate amount'<sup>XII</sup>.
- 7 Larger local councils are required by S 5 of the Local Government Act 1986 to keep a separate account of their expenditure on publicity and make this available to the public. There is no requirement for a disclosure of the publicity account in its main accounts although larger local councils may elect to do so.
- 8 Any 'Other' expenditure within Direct Service or Democratic, Management and Civic Costs expenditure should be analysed into its principal components in a note.

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<sup>XI</sup> This is a requirement of regulation 7(2) (b) the Accounts and Audit Regulations 2003 as amended and is additional to the requirements of the FRSSSE.

<sup>XII</sup> See Section 3(2) of Local Government Act 2003, Schedule 1, Capital Finance: Parish and Community Councils and Charter Trustees – reproduced in Schedule 1 below

4.105 Where revenue items included within the Income and Expenditure Account are funded from capital under the provisions of statute<sup>xiii</sup> this must be reported as follows:

Debit – Capital Financing Account (value of revenue expenditure funded from capital)

Credit – Revenue Expenditure Funded from Capital under Statute.

### **The Statement of Movement of Reserves**

4.106 This Statement reconciles the change in reserves between accounting periods and as such it is a key accounting report for large local councils

4.107 There is no prescribed format for this Statement as it is not a requirement of the FRSSE. However, from the information provided, any person interested should be able to understand the activity on each reserve reported on the balance sheet and see the movements that gave rise to and reconcile the differences between the opening and closing balances. A tabular presentation is considered to be most helpful to the reader.

4.108 Supporting the Statement should be detailed reconciliations explaining the movements in the reserves where these are not already provided elsewhere in the accounts. Where the detail is provided elsewhere in the accounts, the source should be identified at the appropriate place in the Statement of Movement of Reserves.

### **The Statement of Total Recognised Gains and Losses**

4.109 Where it is prepared, the presentation of a statement of total recognised gains and losses should have the same prominence as the income and expenditure account. The statement should include all gains and losses that are not included in the income and expenditure account such as surplus or deficit arising on revaluation of fixed assets.

4.110 In the case of local councils who account for assets on an historic cost basis and account for pensions on a defined contribution basis it is likely that all gains and losses will have been recognised in the income and expenditure account and therefore this statement will not be required.

4.111 If required, the format of the statement is:

- **Surplus or deficit on the income and expenditure account**
- **Surplus or deficit on the revaluation of fixed assets**
- **Actuarial gains or losses on pension fund assets or liabilities (not required for councils accounting for pension funds on a defined contribution basis)**
- **Any other gains or losses.**

4.112 Current accounting period and prior period comparatives are also required.

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<sup>xiii</sup> Capital and Finance Regulations 2003 et al

## The Balance Sheet

+ Intangible Assets (if any)

+ Fixed Assets

Land and Buildings

Vehicles and Plant

Non – operational assets

+ Current Assets

Stock and Work in Progress

Debtors and Prepayments

Short term Investments

Cash at bank and in hand

- Current Liabilities

Creditors and receipts in advance

Current portion of long term debt

= Net Current Assets

= Total Assets less Current Liabilities

- Long Term Borrowing

= Total Assets less liabilities

= Reserves

Usable capital receipts reserves

[Revaluations Reserve – if used]

[Pensions Reserve - if used]

Capital Financing Account

Earmarked Revenue Reserves

General Fund

## Disclosure Notes to the Balance Sheet

- 1 Post balance sheet events: disclosure of any material non adjusting post balance sheet event is required and should include the nature of the event and estimate of its financial effect or a statement that such an estimate cannot be made.
- 2 Tangible Fixed Assets and Depreciation: The notes to the accounts should disclose:
  - the cost or valuation at the beginning of the accounting period;
  - the effect of any revaluation made during the accounting period;
  - acquisitions made during the accounting period; and
  - disposals made during the accounting period.

Fixed Assets note should also disclose:

- the cumulative amount of depreciation at the beginning of the accounting period,
- the amount of any depreciation during the accounting period
- the amount of any adjustments made on disposal during the accounting period
- the amount of any other adjustments made during the accounting period

Note: Investment properties are not depreciated

- 3 Leases:
  - Finance Leases: Assets held under finance leases can either be aggregated with other fixed assets owned by the council along with the accumulated depreciation or be disclosed separately. If disclosed in aggregate the net amount of assets held under finance leases and the amount of depreciation allocated should be separately disclosed. In addition the amount of future obligations related to finance leases should be disclosed.
  - Operating Leases: The note should disclose the payments which the council is committed to make during the next year analysed between those in which the commitment expires within that year, in the second to fifth years inclusive and over five years from the balance sheet date, showing separately the commitments in respect of leases of land and buildings and other operating leases.

## The Auditor's Report

- 4.113 The external auditor will make his report in accordance with guidance issued from time to time by the Auditing Practices Board.

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# Schedule 1 to Part 4 – References

## 1 Section 21 of the Local Government Act 2003 states:

(1) The Secretary of State may by regulations make provision about the accounting practices to be followed by a local authority, in particular with respect to the charging of expenditure to a revenue account.

(2) In any enactment to which this subsection applies, reference to proper practices, in relation to accounts of a local authority, is to those accounting practices:

a) which the authority is required to follow by virtue of any enactment; or

(b) which are contained in a code of practice or other document which is identified for the purposes of this provision by regulations made by the Secretary of State.

(3) In the event of conflict between practices falling within paragraph (a) of subsection (2) and practices falling within paragraph (b) of that subsection, only those falling within paragraph (a) are to be regarded as proper practices.

(4) Subsections (2) and (3) apply to any enactment contained in:

(a) this Act;

(b) any Act passed after or in the same Session as this Act;

(c) the Local Government and Housing Act 1989 (c. 42);

(d) the Audit Commission Act 1998 (c. 18); and

(e) subordinate legislation (within the meaning of the Interpretation Act 1978 (c. 30)) whenever made.

(5) The power under subsection (2) (b) is not to be read as limited to the identification of an existing document.

(6) In this section, 'local authority' includes a parish council, a community council and charter trustees.

**2 Section 3 of Schedule 1 of the Local Government Act 2003 (2003 c 26) -  
Capital Finance: Parish and Community Councils and Charter Trustees states:**

(1) Where a local authority meets any expenditure by borrowing, it shall in each financial year debit the appropriate amount to the account from which that expenditure would otherwise fall to be met; but that duty shall not prevent the authority debiting a larger amount to that account.

(2) The appropriate amount for purposes of sub-paragraph (1) is a sum equivalent to an instalment of principal and interest combined such that if paid annually it would secure the payment of interest at the due rate on the outstanding principal together with the repayment of the principal not later than the end of the fixed period.

(3) Sub paragraph (1) has effect subject to sub-paragraph (4) if:

(a) a local authority makes an advance to any other person and the expenditure incurred in making the advance is met by borrowing; and

(b) the terms of that advance are such that repayment is to be made otherwise than by equal instalments of principal and interest combined.

(4) The local authority may debit to the account from which the expenditure met by the borrowing would otherwise fall to be met sums of different amounts (whether or not including instalments of principal) in respect of different financial years in order to take account of the terms on which its advance falls to be repaid.