



Governance and accountability for Local Councils

A Practitioners Guide 2008 (Wales)



Acknowledgements

The first edition of the Practitioners' Guide for local councils in England and Wales was published in 2002 and was the result of work overseen by a project group with membership drawn from key stakeholders. It was always recognised that the Practitioners' Guide would need to be kept up to date with developments relevant to the local council sector.

Since 2005, community councils in Wales operate within a separate, albeit very similar, legal framework to that of parish councils in England. The responsibility for issuing guidance for Wales has now transferred to Wales. This edition of the guide is the first prepared specifically for local councils in Wales and approved by the Local Councils Audit Liaison Group.

The Local Council Audit Liaison Group was established in September 2007 with members drawn from key stakeholders. One of its objectives is to help ensure that the guidance remains relevant to the needs of local councils in Wales and is updated as appropriate.

The current members of the Local Councils Liaison Group are:

Simon Edge	Wales Audit Office (Chair)
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Emma Prince	BDO Stoy Hayward
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The contributions of the members of the group, and of those individuals who have contributed from time to time to the development of the guide are gratefully acknowledged.

In particular, this first edition of the local council guide for Wales draws on the Practitioners' Guide for local councils in England that is approved by the Joint Practitioners Advisory Group (JPAG). Established as a standing group in April 2002, JPAG's members are drawn from key stakeholders from small bodies in England which are required to prepare an annual return. JPAG's purpose is to develop guidance for small bodies in England.

We are grateful to JPAG for allowing this and for its continuing support.

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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 also explains risk management, internal controls and the role of internal audit. Understanding these and their interrelationship 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;
- the annual governance statement;
- the external auditor's certificate and opinion;
- internal audit's annual report;
- the review of the system of internal audit; and
- risk management.

What is the annual return?

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

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

2.2 The annual return is in four linked sections and it is intended that these are 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 and the return has been designed so that when it has been signed by the auditor and returned to the local council, the three key sections (1-3) can be opened up and easily displayed on most notice boards.

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

- 2.4 Each local council is required by section 151 of the Local Government Act 1972 to appoint a Responsible Financial Officer (RFO) as the person responsible for the administration of its financial affairs¹. 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 and its income and expenditure to which it relates or that it properly presents receipts and payments, as the case may be (see paragraph 2.6 below), and that it is consistent with the council's underlying financial records. The Council must also disclose here if it is a sole managing trustee (see paragraphs 1.30 to 1.42 above)
- 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 £100,000 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, detailed guidance is given, together with examples, about what needs to be done at year-end to convert a receipts and payments account into an income and expenditure account.
- 2.7 Local councils operating below the £100,000 threshold may choose to report either on an income and expenditure basis or on a receipts and payments basis. However, councils that change the basis on which their accounts are presented should ensure that the comparative accounts in the annual return are shown on a consistent basis. Any change in the way that the accounts are presented, i.e. from income and expenditure to receipts and payments (or *vice versa*) must be reported on the annual return e.g. by inserting 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 2.40 to 2.52) that in approving the annual statement of accounts it is satisfied that this has been prepared in accordance with the requirements of the Regulations and proper practices. As with all other decisions made by the council, all of which have a legal implication, councillors have a duty to make themselves familiar with

¹ See paragraph 1.18 above to determine who is responsible for administering the council's financial affairs if no formal RFO appointment has been made

the requirements contained in the Regulations as they are legally responsible as members.

- 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 accounts page 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 six months after the end of the period to which the statement of account relates. The intention behind the 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 September. 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 to the financial year end as possible.
- 2.11 Section 1 of the annual return standardises the presentation of accounts by local councils into a simple, easy to read format. For the benefit of both the compiler and the reader, each of the thirteen line items carries a note of explanation of 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 omissions will lead to additional, avoidable, correspondence with the council for which additional fees will be incurred.
- 2.13 All figures in the annual return should agree to the primary financial records of the council. The RFO must be able to show how the figures in the annual return reconcile to those in the cashbook and other primary records of accounts. Members should expect to see this reconciliation when they are asked to approve the accounts in the annual return.
- 2.14 More detailed accounting guidance to help support completion of the annual return is contained in Part 3.

Explaining significant variances and analytical review

- 2.15 One of the documents called for to accompany the annual return when it is sent by the council to the external auditor is an explanation of significant variances in levels of expenditure and balances.
- 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);
 - 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% which is not matched by a corresponding increase in expenditure requires an explanation. Conversely, a 50% 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% 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. (See also paragraphs 3.91 to 3.96 below).
- 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 Box 7 on the annual return does not equal Box 11, this difference must be explained. The statement of accounts is designed to ensure that Box 7 should equal Box 11.
- 2.25 Councils have no legal powers to hold revenue reserves other than those for reasonable working capital needs or for specifically earmarked purposes. Therefore, whenever a council's year-end reserves are significantly higher than the council's annual precept, an explanation of their make up should be provided.
- 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 (i.e. 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 their knowledge about the council, gain some assurance about consistency and so to plan the audit work accordingly.

Bank reconciliation in support of the annual return

- 2.28 The submission of the annual return must also be accompanied by a copy of the council's bank reconciliation. The bank reconciliation, which must cover all bank accounts held by the local council for whatever purpose, 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

A note about investments

- 2.29 Generally speaking it is rare for a local council to hold investments other than deposit or other short term savings accounts. These short term investments are often used to maximise income from cash balances during the financial year. They should all be included in the bank reconciliation and line 9 of the statement of accounts.
- 2.30 Auditors may wish to confirm the balances of short term investments making up the balance shown in line 9 of the statement of accounts section of the annual return - total cash and short term investments.
- 2.31 From time to time circumstances may require councils to make decisions to hold long term investments e.g. while deciding how to apply the proceeds of a donation or a capital receipt arising from an asset sale.
- 2.32 A long term investment is any investment other than one which is contractually committed to be paid within 12 months or where the body making the investment may require it to be repaid or redeemed within 12 months of the date on which the investment was made.
- 2.33 These investments must be managed within the asset register and in accordance with the Welsh Assembly Government's statutory guidance on investments. The statutory guidance sets out its application to community councils. It requires that

all community councils must follow the key criteria of liquidity and security and councils will need to produce an Annual Investment Strategy once a year. This is a specific requirement for councils with long term investments exceeding £500,000. The guidance is reproduced in Appendix 8.

- 2.34 Long-term investments in assets whose capital values may fluctuate carry considerable risks and require active management. Investment management is a specialist area. Prudent councils will always seek independent professional assistance when developing their investment strategy and before making decisions around this kind of expenditure. The annual investment strategy will consider whether it is appropriate to retain long term investments and comply with the Assembly's investment guidance and relevant legislation.
- 2.35 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.
- 2.36 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. Therefore, long term investments by local councils, other than in interest bearing accounts, must be identified as long-term investment and treated as capital expenditure.
- 2.37 A council may also on occasion decide to support its work by making a loan to a local body. This type of investment creates a long-term asset.
- 2.38 When a council receives shares following a de-mutualisation of a Building Society or similar institution this also creates a long-term asset.
- 2.39 Part 3 below provides guidance on how councils account for and report short-term and long-term investments in the annual return.

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

- 2.40 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.
- 2.41 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.
- 2.42 Councils are expected to make a number of representations or assertions which together comprise an annual governance statement about the accountability of the council. The annual governance statement together with the statement of accounts must be approved at a full council meeting. It is suggested that the minutes record the approval of both the statement of accounts and the annual governance statement.

2.43 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 a sole managing trustee of charitable assets or funds.

1 *"We have approved the statement of accounts which has been prepared in accordance with the requirements of the Accounts and Audit (Wales) Regulations and proper practices"*

2.44 This first statement covers the published 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"*

2.45 This second statement covers the local 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.

2.46 A more detailed discussion about internal controls, which auditors may wish to test, can be found in the section on risk management which starts at paragraph 2.98 below.

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 (Wales) Regulations"*

2.47 The third and fourth statements cover the local council's responsibility to act within the law and to put in place proper arrangements to ensure that its financial affairs are conducted in accordance with the law and relevant regulations, including providing the opportunity for electors to exercise their rights to inspect the financial records and ask questions of the auditor.

2.48 The third statement confirms that the council has only done things that it has the legal power to do, and, at the fourth statement, confirms that it has during the year allowed all persons who may be interested the opportunity to exercise their rights. A positive response confirms that the council has also complied with the codes of practice which it has endorsed and adopted to regulate the way in which it carries out its business.

5 *"We have carried out an assessment of the risks facing the council and taken appropriate steps to manage those risks, including the introduction of internal controls and/or external insurance cover where required"*

- | | |
|---|--|
| 6 | <i>“We have maintained throughout the year an adequate and effective system of internal audit of the council’s accounting records and control systems”</i> |
| 7 | <i>“We have taken appropriate action on all matters raised in previous reports from internal and external audit”</i> |

2.49 The fifth, sixth and seventh statements 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 | <i>“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 on the statement of accounts”</i> |
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2.50 The eighth statement covers the local council’s responsibility to conduct its financial affairs and to put in place proper arrangements to ensure that its financial standing is soundly based.

2.51 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.

<p>Trust funds – – <i>in our capacity as trustee we have:</i></p> <p><i>discharged our responsibility in relation to the accountability for the fund(s) including financial reporting and, if required, independent examination or audit.</i></p>
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2.52 This statement is used by councils that act as sole managing trustee of trust funds or assets who have already answered “Yes” to the note in section 1. This statement confirms that the sole managing trustee has complied with Charities Acts, has arranged for an audit or independent examination of the trust’s accounts (if required) and has completed all appropriate returns to the Charity Commission.

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

2.53 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.

- 2.54 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.
- 2.55 The auditor's report contains an opinion on the accounts. This must state the basis on which the opinion is reached and note any exceptions to the opinion. The opinion in the auditor's report within the annual return represents a limited level of assurance which is appropriate to the circumstances of local councils operating at or below the £1,000,000 threshold. Councils maintaining sound internal controls and other governance arrangements mean that the amount of work required from external auditors to fulfil their statutory duty can be correspondingly reduced to a proportionate level.
- 2.56 Whilst 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, the auditor will report this as an exception to the opinion within the audit report. Item 7 of the annual governance statement made by the council should include consideration of actions taken in response to any auditor opinion qualifications that may have been raised in previous years as well as to reports from internal audit.
- 2.57 If the auditor modifies the opinion in any way this is a qualification of the accounts. However, auditors may also wish to draw the council's attention to matters without qualifying the opinion. Such events are recorded for action by the council, in a separate section of the auditors report below the opinion.
- 2.58 If internal controls within local councils are inadequate, there is an increased risk of error, mistake and fraud. Local councils should consider this as part of its risk management arrangements (see below).
- 2.59 A local council 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.

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

- 2.60 Regulation 6 of the Regulations 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 proper internal audit practices'. The Assembly Government's *Guidance on the Accounts and Audit Regulations 2005*¹

¹ Guidance on the Accounts and Audit (Wales) Regulations 2005 published in April 2005

explains that the non-statutory proper practices in relation to local councils may be found in this Practitioners' Guide.

- 2.61 The purpose of internal audit is to review whether the systems of financial and other control are effective. It is essential that the internal audit function is sufficiently independent of the financial controls and procedures of the council which are the subject of review. The person or persons carrying out the internal audit must also be competent to carry out the role in a way that will meet the business needs of each local council.
- 2.62 Internal audit is an ongoing function reporting at least annually. It is not 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 as appropriate during the financial year to test the existence and adequacy of internal controls.
- 2.63 It would be incorrect to view internal audit as the detailed inspection of all records and transactions of the 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.
- 2.64 Having established what internal audit is and what its relationship with the council should be, it is important for councils to consider whether the internal audit is proportionate to the needs, the size and the circumstances of the council.
- 2.65 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 should be.
- 2.66 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 now 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 OVW development officers or SLCC regional representatives in your area.

2.67 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 an 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 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;
- purchasing an internal audit service from a local firm or specialist internal audit practice. The firm needs to have an understanding of the local government framework and a number of professional firms offer a service to public bodies, authorities and commercial companies. For the largest of local councils a specialist contractor appointment may be appropriate;
- *For practical examples of how local councils have secured internal audit see paragraph 2.73 below.*

2.68 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.

2.69 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, i.e. the council's financial controls and procedures. Therefore, the circumstances in which a council member can demonstrate that they are sufficiently independent of the financial decision making and procedures of the council are difficult to envisage. This is because in order to maintain their independence such a member would need to exclude themselves from the council's key financial decisions

2.70 Similarly, it would be inappropriate for any individual or firm appointed by a council to assist them with their accounting, preparation of financial statements or the annual return, to also be appointed as the internal auditor. 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.

- 2.71 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.
- 2.72 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.
- 2.73 There are a number of practical examples of how local councils have sourced their internal audit service which are shown in the exhibit below:

A number of innovative and creative solutions have been developed by 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 councils¹;
- local panels of officers (usually clerks) providing internal audit services to each other and sometimes wider afield¹;
- 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 SLCC branch (or sometimes in partnership) providing affordable internal audit services;
- individuals identified by SLCC acting under their quality controls to provide internal audit services to local councils.

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

2.74 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.

2.75 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. 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.

2.76 Councils and internal audit may also find the following more detailed guidance on how internal audit is carried out helpful:

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

	Subject	Guidance
2	<p>Financial Regulations:</p> <p>a) Standing Orders</p> <p>b) Payment Controls</p>	<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 OVW or 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>Internal audit should comment on whether the council has reviewed Standing Orders and Financial Regulations for relevance.</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 internal audit will test:</p> <p>(a) In purchase order procedures:</p> <ul style="list-style-type: none"> • that the correct number of estimates, quotes or full tenders depending on estimated value of contract have been obtained (Standing Orders will state the value at which tenders are required; Financial Regulations or Standing Orders will show the value where estimates or quotes only are required); • that proper purchase authority by council, a committee or officers (under clear delegated powers) is in place; and • that a proper legal power has been identified for the expenditure. <p>(b) In purchase payments:</p> <ul style="list-style-type: none"> • that the supporting paperwork confirms that there is a fully approved invoice and authorisation for payment; and • that VAT is identified appropriately for reclaim. <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 £1000, 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. 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>

	Subject	Guidance
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.</p> <p>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.</p> <p>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 2.98 below.</p>
4	Budgetary controls	<p>Internal audit will not check the budget but will verify that when setting the precept, a budget has been properly prepared and adopted.</p> <p>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 are held. 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 3.31 onwards.</p>
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>

	Subject	Guidance
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:</p> <ul style="list-style-type: none"> • that reimbursement is regular; and • evidence that on occasions an independent person has physically counted the cash balance and checked this to be in agreement with the up-to-date record. <p>The council should have a system for the regular approval of petty cash expenditure.</p>
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 the HM Revenue & Customs (HMRC). 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. As an “office holder”, the clerk is always regarded as an employee. If a deduction for tax or national insurance is not made by the employer HMRC has the right to seek the lost tax and contributions from the employer as if the payments made were after deduction of the appropriate amounts (i.e. the amount sought is “grossed up”). There may also be a liability for interest and penalties that can increase the sum significantly.</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 HMRC. HMRC seek to avoid setting up a PAYE scheme for a single employee whenever possible, so will seek to “code out” any community council salary through other income, pension scheme or by direct assessment. The council should have a letter from HMRC (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>

	Subject	Guidance
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 to the annual financial statements 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.</p> <p>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 Assembly Government published in March 2004. 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 transactions 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. Bank reconciliations should be prepared frequently. In larger councils, this may be on a monthly basis and at least quarterly for smaller councils. It is not appropriate to wait until the year end before preparing the reconciliation.</p> <p>Internal audit will wish to see that the financial records or cash book have been reconciled to bank statements, but should not undertake the reconciliation unless it requires re-performance. It may be appropriate for the year end balances and their reconciliation to be checked in detail.</p> <p>The basic cash book record must not be written up from the bank statements as this 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 a level of internal control.</p> <p>The bank reconciliation should include a note of the cost of short term investments held by the council. This is to:</p> <ul style="list-style-type: none"> • enable monitoring of the investments to ensure that these funds are performing in the way planned by the council; and • so that the council can have, each time this is reviewed, as complete a picture as possible of its liquidity and available funds. <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>

	Subject	Guidance
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:</p> <ul style="list-style-type: none"> • the appropriate accounting basis is used; • the figures can be followed through on working papers; and • adjustments, transfers, contra entries etc are fully explained and justified. <p>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>

- 2.77 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 mistakes. Internal audit'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.
- 2.78 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 Auditor General, and from the legislation under which they are appointed and work.
- 2.79 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.
- 2.80 A possible approach to testing by internal auditors is contained in Appendix 9 to this guidance. This is not a checklist requiring completion, but a suggested method of approach.

The review of the system of internal audit

What does the law say you have to do?

- 2.81 The Regulations require councils to carry out an annual review of the effectiveness of their system of internal control. This review is an integral part of continually improving governance and accountability. Internal audit is an integral part of the system of internal control.

- 2.82 As best practice and as part of the review of internal control, local councils should at least once a year carry out a review of internal audit. The results should be included in the annual governance statement which is part 2 of the annual return.
- 2.83 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.

What needs to be reviewed?

- 2.84 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*'.
- 2.85 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 2.60 to 2.81 above. This will include as a minimum making an assessment of each of the following:
- The scope of internal audit;
 - Independence;
 - Competence;
 - Relationships; and
 - Audit planning and reporting

Who should carry out the review?

- 2.86 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/RFO and certainly not to internal audit.
- 2.87 Although the internal audit provider cannot be allowed to influence the direction or extent of the review, it is considered good practice to seek their input into the process.
- 2.88 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.
- 2.89 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?

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

What evidence can be used?

- 2.93 Wherever possible, evidence to support the review should be gathered throughout the year. There are many possible sources of evidence and some examples are set out below:
- Previous year's review and action plan;
 - Annual report by internal audit;
 - Periodic reports from internal audit, if any, which could include one or more of the following:
 - an internal audit plan;
 - cyclical internal audit monitoring reports;
 - the results of any investigations; and
 - review of performance indicators, if used;
 - Any reports by the external auditor covering internal audit work or on key financial systems; and
 - Results of any other external reviews of internal controls or aspects of them.

What is the outcome of the review?

- 2.94 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.
- 2.95 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. The council should regularly monitor progress in implementing any recommendations identified.

What is the timescale?

- 2.96 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. Therefore, councils must allow time for the review in drawing up their timetable for the completion of the annual return.
- 2.97 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?

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

Internal Audit Review Checklist 1 Meeting the 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>The Clerk and Responsible Financial Officer (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 2 Characteristics of Effectiveness

Characteristics of 'effectiveness'	Evidence of Achievement	Yes or No	Areas for development
Internal audit work is planned	Planned internal audit work is based on risk assessment and designed to meet the council's needs.		
Understanding the whole organisation its needs and objectives	The annual audit plan demonstrates how audit work will provide assurance for the council's Annual Governance Statement.		
Be seen as a catalyst for change	Internal audit supports the council's work in delivering improved services to the community.		
Add value and assist the organisation in achieving its objectives	The council makes positive responses to internal audit's recommendations and follows up with action where this is called for.		
Be forward looking	In formulating the annual audit plan, national agenda changes are considered. Internal audit maintains awareness of new developments in the services, risk management and corporate governance.		
Be challenging	Internal audit focuses on the risks facing the council. Internal audit encourages managers/members to develop their own responses to risks, rather than relying solely on audit recommendations.		
Ensure the right resources are available	Adequate resource is made available for internal audit to complete its work. Internal audit understands the council and the legal and corporate framework in which it operates.		

Risk management

- 2.99 In all types of undertaking there is the potential for events and consequences that may either be opportunities for benefit or threats to success. Local councils are no different and risk management is increasingly recognised as being central to their strategic management.
- 2.100 Risk management is the process whereby local councils methodically address the risks associated with what they do and the services which they provide. The focus of good risk management is to identify what can go wrong and take steps to avoid this or successfully manage the consequences.
- 2.101 Risk management is not just about financial management; it is about achieving the objectives of the organisation 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 the local community's Council Tax bills.
- 2.102 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.
- 2.103 The importance of looking afresh at risk comes in the wake of a more demanding society, bold initiatives and more challenge when things go wrong. Local authorities currently face pressures 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.
- 2.104 Members are ultimately responsible for risk management because risks threaten the achievement of policy objectives. As a minimum, members should, at least once each year:
- take steps to identify and update 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.
- The risk assessment review should be formally reported to the council and minuted as evidence that the review has been conducted.
- 2.105 It is impossible and potentially dangerous to attempt to present a suggested list of the risks which local councils face and this guidance does not do this. The nature, complexity and scale of the business of councils vary. Similarly the priorities and service delivery objectives of one council will differ from those of others. For this reason each council must identify for itself the key risks to achieving successfully its priorities and service objectives. Identifying risks can be a daunting task and so local councils may find it helpful to use as a starting point the examples

of risk set out in the three tables at the end of this section of the guidance.

- 2.106 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 OVW and SLCC directly, and/or the council's insurance provider and by reference to various elements of the National Training Strategy.
- 2.107 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.
- 2.108 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.
- 2.109 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, this impedes the council's ability to bid for funds in future.
- 2.110 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 the risks.
- 2.111 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 can face are given in the three tables at the end of this section of the guidance.
- 2.112 The council's internal auditor will have 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.
- 2.113 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].

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

Table 1

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

Risk identification

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

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

Internal controls

A council's internal controls may include:

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

Internal audit assurance

Internal audit testing may include:

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

Table 2

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

Risk identification

The limited nature of internal resources in most local councils means that councils wishing to provide services often buy them in from specialist external bodies, e.g.

- ✓ Security for vulnerable buildings, amenities or equipment
- ✓ Maintenance for vulnerable buildings, amenities or equipment
- ✓ The provision of services being carried out under agency/partnership agreements with principal authorities
- ✓ Banking arrangements, including borrowing or lending
- ✓ Ad hoc provision of amenities/ facilities for events to local community groups
- ✓ Markets management
- ✓ Vehicle or equipment lease or hire
- ✓ Trading units (leisure centres, playing fields, burial grounds, etc)
- ✓ Professional services (planning, architects, accountancy, design, etc)

Internal controls

A council's internal controls may include:

- ✓ Standing orders and financial regulations dealing with the award of contracts for services or the purchase of capital equipment
- ✓ Regular reporting on performance by suppliers/providers/contractors
- ✓ Annual review of contracts
- ✓ Clear statements of management responsibility for each service
- ✓ Regular scrutiny of performance against targets
- ✓ Adoption of and adherence to codes of practice for procurement and investment
- ✓ Arrangements to detect and deter fraud and/or corruption
- ✓ Regular bank reconciliation, independently reviewed

Internal audit assurance

Internal audit testing may include:

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

Table 3

Areas where there may be a need to self-manage risk

Risk identification

There are a number of activities that create business risks but do not fall easily into either of the above categories for a number of reasons, principally because they are either difficult to quantify or considered inefficient to have provided externally or just uninsurable.

- ✓ Keeping proper financial records in accordance with statutory requirements
- ✓ Ensuring all business activities are within legal powers applicable to local councils
- ✓ Complying with restrictions on borrowing
- ✓ Ensuring that all requirements are met under employment law and regulations
- ✓ Ensuring all requirements are met under HM Revenue and Customs Notices and regulations (Income Tax, National Insurance and VAT)
- ✓ Ensuring the adequacy of the annual precept within sound budgeting arrangements
- ✓ Monitoring of performance against agreed standards under partnership agreements
- ✓ Ensuring the proper use of funds granted to local community bodies under specific powers or under section 137
- ✓ Proper, timely and accurate reporting of council business in the minutes
- ✓ Responding to electors wishing to exercise their rights of inspection
- ✓ Meeting the laid down timetables when responding to consultation invitation
- ✓ Proper document control
- ✓ Register of Members' Interests and Gifts and Hospitality in place, complete, accurate and up to date

Internal controls

A council's internal controls may include:

- ✓ Regular scrutiny of financial records and proper arrangements for the approval of expenditure
- ✓ Recording in the minutes the precise powers under which expenditure is being approved

Internal controls (continued)

- ✓ Regular returns to HM Revenue & Customs; contracts of employment for all staff, annually reviewed by the Council, systems of updating records for any changes in relevant legislation
- ✓ Regular returns of VAT; training the responsible officer in matters of VAT and other taxation issues as necessary
- ✓ Regular budget monitoring statements
- ✓ Developing systems of performance measurement
- ✓ Procedures for dealing with and monitoring grants or loans made or received
- ✓ Minutes properly numbered and paginated with a master copy kept in safekeeping
- ✓ Documented procedures to deal with enquiries from the public
- ✓ Documented procedures to deal with responses to consultation requests
- ✓ Documented procedures for document receipt, circulation, response, handling and filing
- ✓ Procedures in place for recording and monitoring Members' interests and Gifts and Hospitality received.
- ✓ Adoption of codes of conduct for members and employees.

Internal audit assurance

Internal audit testing may include:

- ✓ 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