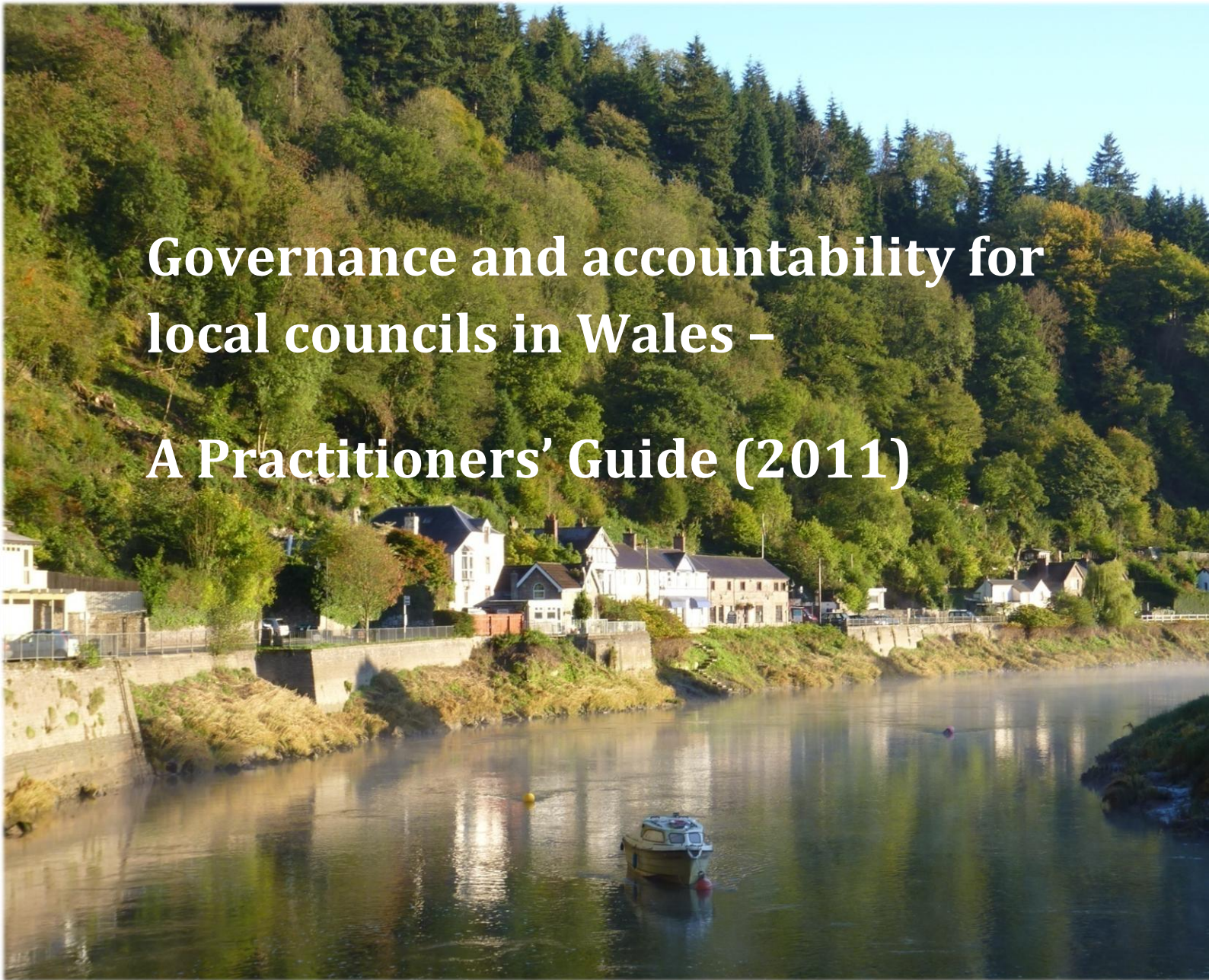


Governance and accountability for local councils in Wales – A Practitioners' Guide (2011)



Un Llais Cymru



One Voice Wales

Society of
Local Council Clerks

Part 2 – Governance for local councils

Part 2: Governance for local councils – Contents

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Chapter 6: The Annual Governance Statement

This chapter describes the purpose of the Annual Governance Statement and explains what each of the assertions made in the governance statement means.

What is the Annual Governance Statement?

1. The Annual Governance Statement is an assessment by the council that it:
 - conducted its business in accordance with the law and proper standards;
 - safeguarded and properly accounted for public money; and
 - used its resources economically, efficiently and effectively.
2. As part of the Annual Governance Statement, the council will consider a number of areas and make a series of assertions or representations about how it has conducted its affairs during the year. These areas cover:
 - Preparing the statement of accounts;
 - Maintaining adequate internal controls;
 - Compliance with the law and codes of practice;
 - Providing for electors' rights;
 - Managing risk;
 - Internal audit;
 - Responding to audit reports;
 - Litigation, liabilities and commitments; and
 - Trust funds.
3. The following sections explain these assertions in more detail. For each statement we provide a brief explanation along with information on where you can find further guidance.

What does the Annual Governance Statement say?

1. We have approved the Statement of Accounts that has been prepared in accordance with the requirements of the Accounts and Audit (Wales) Regulations and proper practices.

4. This first statement refers to the published accounts of the local council.
5. By approving the accounts and the Annual Governance Statement, the council asserts that it has prepared those accounts in the way prescribed by the law and in accordance with proper practices. Parts 3 and 4 of this guide explain in more detail the legal requirements for the accounts.
6. Before making this assertion, the council should ensure it reviews the accounting statements and consider if they are:
 - complete and in accordance with the supporting records;
 - prepared on the correct basis and in accordance with this guide; and
 - supported by sufficient evidence and explanation needed by the council.

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

7. This second statement refers to the council's responsibility to ensure that it manages its affairs in accordance with proper standards of financial conduct. A sound system of internal control is essential to achieve this. The system of internal control comprises the financial checks and balances the council has in place to protect its money and other resources. These controls help to prevent and detect fraud and corruption.
8. In order to make this statement, the council must review the effectiveness of its system of internal control and test the following arrangements at least once a year:
 - the overall control environment, including internal audit
 - budgetary control and monitoring arrangements; and
 - the documentation and application of control procedures.
9. In order to make this statement, the council must review and test these arrangements at least once a year to make sure that they are working in an adequate and effective way. Such a review is a legal requirement of the Regulations.
10. Chapter 7 contains a more detailed discussion on internal controls. The Wales Audit Office's Good Practice Exchange (<http://www.wao.gov.uk/2594.asp>) also includes additional guidance on financial checks and balances.

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 that could have a significant financial effect on the ability of the council to conduct its business or on its finances.

11. This third statement deals with the council's responsibility to act within the law. Local councils are statutory bodies. As such, they only have power to act where allowed by the law. By making this statement, the council confirms that it has only done things where it has the legal power to do so and that it has complied with any relevant codes of practice.
12. In order to make this statement, the council needs to make arrangements for monitoring the legal basis under which it acts.

4. We have provided proper opportunity for the exercise of electors' rights in accordance with the requirements of the Accounts and Audit (Wales) Regulations.

13. The Public Audit (Wales) Act gives members of the public certain rights related to the accounts and the audit. Members of the public may inspect the accounts and the related records or contact the external auditor. The Regulations require the accounts and supporting records to be available for inspection for 20 working days prior to a date

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specified by the appointed auditor. Electors may also question the auditor about the accounts or make objections to items in the accounts.

14. It is important that the council allow members of the public to exercise these rights under the Act. This fourth statement, confirms that the council has during the year allowed all persons who may be interested the opportunity to exercise their rights under the Act.
15. Before making this statement, the council should ensure that it has advertised the audit properly. It should also ensure there were adequate arrangements in place for the inspection of the accounts. Further information on electors' rights under the Act and Regulations is set out in chapter 23.

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.

16. This statement deals with the council's responsibility to identify, evaluate and manage operational and financial risks.
17. The council should ensure that a full review of risks is undertaken at least annually. This review should be formally reported to the council. Further guidance on risk management is included in chapter 9.

6. We have maintained an adequate and effective system of internal audit of the council's accounting records and control systems throughout the year and have received a report from the internal auditor.

18. Regulation 6 of the Accounts and Audit (Wales) Regulations 2005 (as amended) requires all local councils to "maintain an adequate and effective system of internal audit..."
19. Internal audit is an ongoing function rather than one that is only completed at the year-end. To complete this statement, councils will need to review the internal audit report and consider if the scope and extent of audit provides the assurance they need.
20. Further guidance on internal audit is included in chapter 8.

7. We have taken appropriate action on all matters raised in previous reports from internal and external audit.

21. As part of the normal reporting process, both internal and external auditors report their key findings to the council. They may also recommend improvements to internal systems. To ensure that internal controls and governance arrangements are effective, the council should take the actions agreed in response to auditors' reports on a timely basis.
22. A review of the actions taken in response to auditors reports will allow the council to make this statement.

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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 on the Statement of Accounts.

23. The eighth statement covers the local council's responsibility to conduct its financial affairs properly and to put in place proper arrangements to protect its financial standing
24. This statement provides assurance that the council has considered and disclosed in the annual return all matters relevant to its business. This includes any relevant events that have taken place in the period between the end of the financial year 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 trustee we have discharged our responsibility in relation to the accountability for the fund(s) including financial reporting and, if required, independent examination or audit.

25. Councils that act as sole managing trustee of trust funds or assets and have already answered "Yes" to the note in section 1 use this statement. This statement confirms that the sole managing trustee has:
- complied with Charities Acts;
 - arranged for an audit or independent examination of the trust's accounts (if required); and
 - completed all appropriate returns to the Charity Commission.

In order to provide this assurance, the council will need to check that the trust fund's accounts have been subject to an independent examination or audit and that the relevant charity Commission returns have been submitted.

Chapter 7: Internal controls or checks and balances

This chapter describes the nature of internal controls and sets out how local councils operate controls.

What are internal controls?

26. Internal controls are essential checks and procedures that help council members:
 - meet their responsibilities to safeguard the council's assets;
 - administer the council's finances and assets in a way that identifies and manages risk; and
 - ensure the quality of financial reporting by keeping proper accounting records and preparing timely and relevant financial information.
27. These checks and balances will include procedures to receive money, make payments, record financial transactions and by its internal audit, to check that this is being done.
28. Internal controls reduce but do not remove completely, the risk of losses through:
 - theft and fraud;
 - poor decision-making;
 - human error;
 - breaches of controls and unforeseeable events.

Although the risks are not completely removed, internal controls should also help members to detect problems sooner and take any necessary action.
29. The type of financial checks and balances the council puts in place will depend on the size of the council and the range of services the council provides. Larger councils providing a wider range of services will need a wider range of checks and balances than smaller councils. However, every council must have some basic checks and balances.
30. Generally, controls are of two types:
 - Preventative Controls: that are designed to discourage errors or irregularities from occurring (i.e., processing vouchers only after signatures have been obtained from appropriate personnel), and
 - Detective Controls: these find errors or irregularities after they have occurred (i.e. reviewing bank statements for items not in the cashbook).

Who is responsible for internal controls?

31. Regulation 4 states that the council is responsible for putting in place and ensuring that there is a sound system of internal control. This system must facilitate the effective exercise of the council's functions, include arrangements to manage risk and secure adequate and effective financial management.
32. The tone at the top created by members will embed a culture of proper control in the council as a whole. Members should therefore lead by example in adhering to the established internal controls and good practice.
33. Regulation 5(1) states that the RFO must determine on behalf of the council and after consideration of proper practices, its accounting control systems. The Regulation notes that the RFO shall also ensure that the accounting control systems are observed.

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34. Regulation 5(4) specifies that the accounting control system shall include:

- a) 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 record
- b) identification of the duties of officers dealing with financial transactions and division of responsibilities of those officers in relation to significant transactions
- c) procedures to ensure that uncollectable amounts, including bad debts, are not written off except with the approval of the responsible financial officer, or such member of that person's staff as is nominated for this purpose, and that the approval is shown in the accounting records; and
- d) measures to ensure that risk is appropriately managed

35. Therefore, there is a joint responsibility between the members and the RFO to ensure an adequate system of internal control exists.

What is the review of the system of internal control?

36. Regulation 4 also requires the council to review at least once a year, the effectiveness of the system of internal control and to prepare a statement on internal control.
37. The Welsh Assembly Government, in its guidance on the Regulations, considers that the annual governance statement included in the Auditor General's annual return serves the purpose of the annual statement of internal control.
38. Further guidance on completing the annual governance statement is included in Chapter 6.
39. In order to review the system of internal control, the council must first understand the nature of the control system and its various components. These will include:
- high level controls providing an overall framework; and
 - specific controls related to activities and transactions.
40. The annual review should include an assessment of whether the controls:
- operated during the year;
 - are relevant and appropriate for the council, and
 - are not too onerous or disproportionate.

High level internal controls

41. The following high level controls should be in place at all councils:

Control area	
Segregation of duties	A key feature of an effective control framework is to ensure that where possible, no single individual has sole responsibility for any transaction from authorisation to completion and

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	<p>review.</p> <p>For smaller councils there may be particular resource constraints that make proper segregation of duties difficult to achieve. However, members can take action to compensate for these difficulties. For example, members reviewing reports of transactions independently of the RFO.</p>
Budgetary control	<p>One of the most important financial monitoring activities is budgetary control. This is monitoring the council's performance against its budget. The council should have procedures for regular budget reporting in place.</p> <p>More detail on budgets is set out in chapter 13.</p>
Internal audit	<p>The role of internal audit is to look at the effectiveness of the council's financial controls. The members should consider reports prepared by the internal auditor that identify weaknesses in internal control.</p> <p>More detail on internal audit is included in chapter 8.</p>
Payments	<p>The use of cheque payments is diminishing with the use of electronic payment. It is essential that the council has robust controls in place over payments made.</p> <p>More detail on controls over payments is included in chapter 11.</p>

Internal controls over activities and transactions

42. The following table contains advice covering internal controls over a range of financial activities. When using this guidance, councils and RFOs should focus on the sections that are relevant to their particular council. For example, if the council does not use electronic banking the section will not be relevant. The lists are not exhaustive but should assist councils to develop their own internal control system.

Control area	Control objective	Example controls
Income received	The controls in place should provide assurance that the income received is secure, accurately recorded and banked as quickly as possible.	<p>All cash and cheques received should be recorded and banked as soon as possible. The following controls should be in place:</p> <ul style="list-style-type: none"> • Where possible, at least two people are involved in handling and recording monies received; • Cash collected is banked as soon as possible without deduction of expenses; • Records are kept of each source of funds or fundraising event in enough detail to identify gross receipts or takings and costs incurred; • Pre-numbered, carbon copy receipts are issued for all payments received.
Trading	Trading includes all goods	Controls will depend on the type of

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income and fees	and services provided for a fee. Controls should ensure that all income due to the council is received and recorded.	<p>activity carried out by the council. Controls should generally include:</p> <ul style="list-style-type: none"> • Establishing a pricing policy for goods and services supplied including regular review of price structures; • Invoicing procedures for all goods and services provided; • Review of outstanding debts and collection procedures; • Procedures to reconcile goods and services provided to amounts invoiced and cash received to outstanding balances.
Income records	Internal controls should ensure the council accurately maintains accounting records of income.	<p>Certain basic controls performed regularly may serve as an early warning of anything going wrong. Regular checks should be made to ensure that:</p> <ul style="list-style-type: none"> • Records of cash and cheques received agree with bank paying in slips; • Paying in slips agree with bank statements both in terms of amount banked and date of credit; and • Transfers or other direct payments into the bank are verified against supporting paperwork. <p>These checks should be made by someone other than the person concerned with the original recording of the transactions.</p>
Authorisation of expenditure	Expenditure controls ensure that only necessary and authorised purchases are made. Controls also ensure that the council makes payments only for goods and services actually received and at agreed prices.	<p>Controls over purchases may include:</p> <ul style="list-style-type: none"> • Establishing authority levels for placing orders and approving payments which are clear and documented; and • Ensuring invoices received are checked against orders to confirm prices and the receipt of the goods or services ordered.
Wages and salaries	The purpose of payroll controls is to make sure that the council pays the correct amounts to genuine employees and HMRC.	<p>The payment of wages and salaries is often a major item of a council's expenditure and therefore adequate control over these payments is essential. In addition to paying employees, the controls should ensure that the council is not exposed to additional liabilities from breaches of statutory regulations e.g. by</p>

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		<p>failing to correctly deduct tax and national insurance.</p> <p>Internal controls should be established to should ensure that:</p> <ul style="list-style-type: none"> • PAYE records are maintained for all employees; • Statutory deductions are paid to HMRC and pension contributions paid to pension providers promptly; • Deadlines for year end returns to HMRC are met e.g. P35, P11D and P60; • Minimum wage legislation is adhered to; • Only authorised or required deductions are made from pay; • All employees have a proper contract of employment and individuals are not incorrectly classified as self employed; • Personnel records are checked against pay records periodically to prevent payments to former employees; • Changes to pay, hours, overtime or non-standard hours are authorised promptly; and • No individual has the authority to set his or her own pay.
Assets	Internal controls should be in place to safeguard the assets and investments held by the council from loss or damage and to ensure their proper use within the community.	<p>Internal controls may include:</p> <ul style="list-style-type: none"> • Maintaining an asset register (see chapter 17 for further detail); • Regular inspection of fixed assets to ensure they exist, remain in good repair and are being used appropriately; • Appropriate authorisation for the disposal or scrapping of fixed assets; and • Maintaining secure boundaries of any land and buildings held by the council and holding all title deeds securely.
Investments	Internal controls should ensure that the councils investments are safeguarded	<p>Controls should include:</p> <ul style="list-style-type: none"> • Setting an investment policy (see chapter 10 for more detail on managing investments); • Maintaining records of all investments held; and

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		<ul style="list-style-type: none"> Accounting controls to ensure that all dividends, rent or interest payments due are received.
Bank accounts	<p>Controls over bank accounts ensure that the amount of money held at any given point in time can be identified and that this money is secure</p>	<p>Controls should include:</p> <ul style="list-style-type: none"> Monthly preparation of bank reconciliations for all accounts. A second person should review the reconciliations and resolve any discrepancies. For more detail, see chapter 16; and Keeping a list of all bank accounts and reviewing it for dormant accounts, which should be closed. <p>To maintain the security of bank accounts, the following controls should be in place:</p> <ul style="list-style-type: none"> Segregation of duties to prevent any single person being able to control the council's resources; Proper approval for movements between and payments from bank accounts. For more detail, see chapter 11; After each electronic banking transaction, a print out should be taken showing transaction details and stored as part of the accounting record; Keeping all PCs with access to online banking facilities secure; Ensuring all PCs are up to date with anti virus, spy ware and firewall software; Adequate training for those using the electronic banking facility; and Changing access passwords periodically and following changes in authorised employees and members.

Chapter 8: Internal audit

This chapter explains why local councils need internal audit and describes good practice for the internal audit arrangements. It is relevant to all local councils.

Why does the council need an internal audit?

43. Regulation 6 requires local councils to ‘maintain an adequate and effective system of internal audit.’ Internal audit must look at the accounting records and the system of internal control. It must also comply with proper internal audit practices. This guidance provides non-statutory proper practices in relation to local councils.

What is the purpose of internal audit?

44. 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 that 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.
45. Internal audit is an ongoing function but must report at least annually. There is no requirement to only carry out an internal audit once each financial year. Nor does the audit 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.
46. Internal audit does not involve 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 the council’s internal controls. The internal audit report should help to improve the council’s operating procedures. Managing the council’s internal controls should be a day-to-day function of the staff and management.
47. It is important for councils to consider whether the internal audit is proportionate to the needs, the size and the circumstances of the council.
48. 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.
49. The council must determine the necessary scope and extent of its internal audit. It must also make sure that it is fit for the purpose for which it is required at that particular council. The following section set out how local councils secure internal audit. One Voice Wales and SLCC officers may also have up to date information about locally available sources of internal audit.

Who can be appointed as an internal auditor?

50. Local councils secure internal audit in various ways. The following table sets out a range of options. 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.

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Local councils secure an internal audit in various ways including:

- appointing a local individual or a member of a panel of individuals. 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 166 below.

51. 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.
52. Independence means that the internal auditor must not be involved in the council's management or administrative roles. Members would find it difficult to demonstrate that they are sufficiently independent of the financial decision-making and procedures of the council. In order to maintain their independence such a member would need to exclude themselves from the council's key financial decisions.
53. In the same way, it would be inappropriate for someone engaged by the council to assist with bookkeeping or preparing the statement of accounts to be the internal auditor.
54. Councils should be aware of possible conflicts of interest when appointing an internal auditor. For example, providers of accounts software may offer internal audit services through an associate company, firm or individual.
55. Councils should not ask those charged with carrying out internal audit 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.
56. There is no requirement for a person providing the internal audit role to be professionally qualified. However, the essential competencies needed for 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.
57. There are a number of practical examples of how local councils have sourced their internal audit service which are shown in the exhibit below:

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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 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 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

What does the internal audit involve?

58. The duties of internal audit relate to reporting to the council on the adequacy of systems of control. Section 4 of the annual return includes an internal audit annual report. The guidance given within the annual return is necessarily brief.
59. The work of internal audit should be subject to an engagement letter on first appointment by the Council. This letter sets 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.
60. Appendix 3 sets out detailed guidance on internal audit. Councils and internal auditors may find this helpful.
61. It is not possible to draw up a standard internal audit programme for local councils. This is because the audit programme must address the particular needs of each council. Councils must also recognise that internal audit's function is to test and report to them on whether the council's system of internal control is adequate and working satisfactorily. It is not for internal audit, nor the external auditor, actively to seek evidence of fraud,

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corruption, error or mistakes. Internal audit's role is to assist the council to fulfil its responsibility to have and maintain proper arrangements for the prevention and detection of fraud, error or mistakes.

62. It is proper for internal audit to carry out other tests on the systems of the council. The external auditor or the council's own risk management process may suggest such tests. The council should receive reports on all such work. Any internal audit report addressed to the council, may suggest actions required by the council. The council should treat these documents as documents open to view by local taxpayers.
63. A possible approach to testing by internal auditors is contained in Appendix 4 to this guidance. This is not a checklist requiring completion, but a suggested method of approach.

Annual review of internal audit

64. Regulation 4 requires councils to carry out an annual review of the effectiveness of their system of internal control. This review is a vital part of improving governance and accountability. Internal audit is an integral part of the system of internal control.
65. 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.
66. The review must reflect the council's internal audit needs and usage. It should provide sufficient assurance for the council that internal audit's work meets required standards and is effective. Councils must judge the extent and scope of the review by reference to their own individual circumstances.

What should the review cover?

67. The starting point for the review should be an assessment against the internal audit standards set out below. This will include as a minimum making an assessment of each of the following:

Standard	Considers
Scope of internal audit	The terms of reference and the extent of the work undertaken by internal audit
Independence	The extent to which the internal auditor is able to carry out the audit without undue influence or conflict of interest
Competence	The ability and experience of the internal auditor to undertake the work
Relationships	The clarity of relationships between the council, the clerk and the internal auditor
Audit planning and reporting	The effectiveness of the audit plan and reporting procedures

68. The review should focus on the internal audit standards identified 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.

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69. Councils should not judge internal audit's effectiveness solely by the extent of compliance with expected standards. The review is mainly about how effective internal audit is, not the process it followed. In essence, the review should focus 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.
70. Appendix 5 provides a checklist to assist councils in carrying out the review. It covers the two principal aspects of the review i.e. compliance with standards and overall effectiveness.

Who should carry out the review?

71. A key point to note is that it is the council's responsibility to carry out the annual review. This is not a review that the external auditor can carry out as part of the annual audit. Nor can it be delegated to the clerk/RFO or to internal audit.
72. Although the internal audit provider must not influence the direction or extent of the review, it is good practice to seek their input into the process.
73. There are no hard and fast rules as to who actually performs the review or how it is carried out. Councils may wish to set up a small working party for this purpose or ask an appropriate committee. However the council completes the review, because of the link to the council's Annual Governance Statement, a full meeting of the council should receive and consider the results.
74. No single approach will suit all local councils. Much will depend upon the size of the council and arrangements in place to conduct the wider review of the system of internal control and risk management.

What evidence supports the review?

75. Wherever possible, reviewers should gather evidence to support the review 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?

76. 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 include an opinion as to whether or not the internal audit system is effective.

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77. Aside from the need to report publicly 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?

78. 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.
79. The council should monitor the action plan from the previous year's review throughout the year, linked to the way that it monitors the Annual Governance Statement action plan.

Is training available?

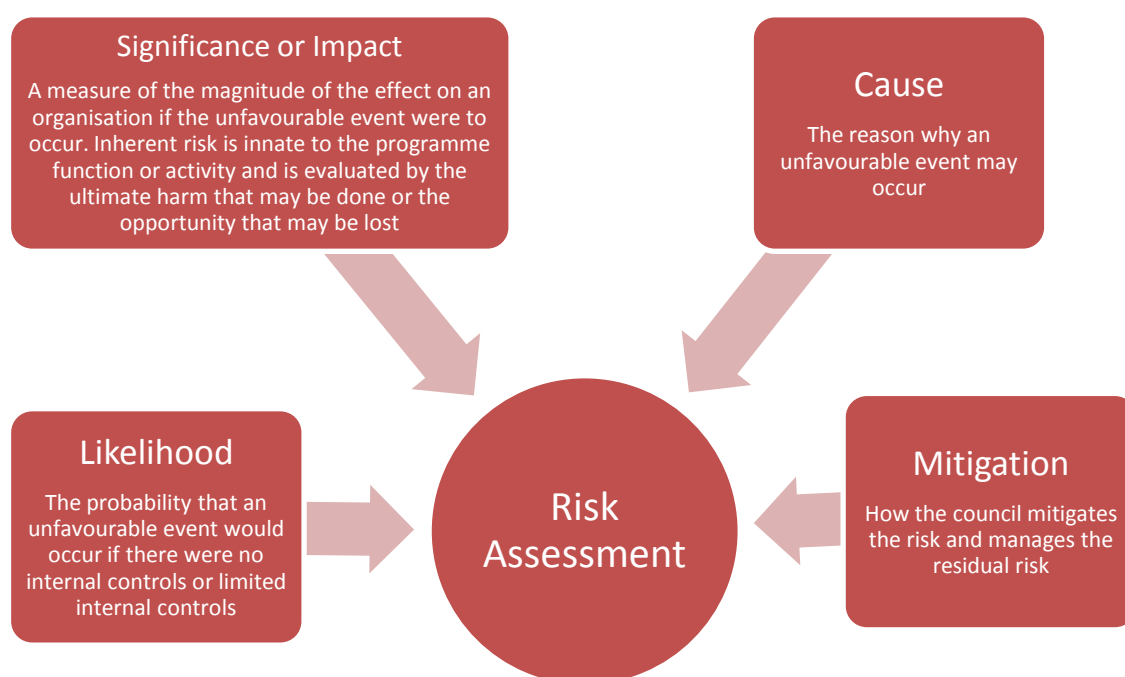
80. Those carrying out the review of internal audit will need to understand the purpose of the review, what it includes and how to carry it out. Training on this may be delivered by One Voice Wales and SLCC or from the local unitary authority.

Chapter 9: Risk assessment

This chapter explains how local councils can identify and address the risks they face in delivering public services.

What are risks and risk assessment?

81. In all types of public body, there is the potential for events and consequences that may either be opportunities for benefit or threats to success. Local councils are no different. Risk management is recognised as being central to their strategic management.
82. Risks are events that threaten the achievement of objectives. There are both internal and external risks. Examples of risks include human error, fraud, system breakdowns and natural disasters. The risk assessment process involves identifying each risk in terms of:



What is risk management?

83. Risk management is the process where local councils methodically address the risks associated with what they do and the services that 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.
84. Risk management is not only financial management. It is about meeting the objectives to deliver high quality public services. Failure to manage risks effectively can be expensive in terms of litigation and reputation, the ability to achieve desired targets. In the long term, these affect the local community's council tax bills.
85. The Auditor General's audit approach encourages local councils to deal with these issues. It emphasises the need to keep under review and strengthen councils' governance

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- arrangements. This improves councils' stewardship of public funds and provides positive and continuing assurance to taxpayers.
86. 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 councils currently face pressures that may lead to a range of new and complex risks. Therefore, effective risk management is more important now than at any other time.
 87. Because of the impact on policy objectives, members are responsible for risk management. 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.
 88. The council should receive a formal report on the risk assessment review. The council's minutes should record that the council conducted the review.
 89. It is not possible to present a full list of the risks faced by local councils. The nature, complexity and scale of the business of councils vary as do their priorities and service delivery objectives. This is why each council must identify for itself the key risks to successful achievement of 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 chapter.
 90. Both One Voice Wales and SLCC offer support for councils wishing to improve their risk management arrangements. Further guidance may also be available from the council's insurance provider and by reference to various elements of the National Training Strategy.
 91. 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.
 92. For example, a single large capital project will present a number of individual risks. Each of these will require evidenced assessment and response to make the project manageable. The risk assessment in such a case may well lead to the 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.
 93. The consequences of an identified risk may include financial loss. However, even if the immediate impact is not financial e.g. an adverse impact on the council's reputation, this can have financial consequences in the longer term. For example, if this impedes the council's ability to bid for funds in future.
 94. 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. Councils can also do this using high, medium and low likelihood 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.
 95. After identifying and evaluating risks, councils need to decide upon appropriate measures to take to avoid, reduce or control the risks or their consequences. The tables at the end

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of this chapter give examples of control measures relevant to some of the risk areas that councils can face.

96. 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 are set out in the three tables at the end of this section.

How can risk be managed?

97. 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].
98. The tables are not intended to be exhaustive and they cover topics that may not be relevant to all councils. They are intended to create a starting point for the development of a system of risk management for each local council.

Risk management

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

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Table 2: Areas where there may be scope to work with a third party 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

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Table 3: Areas where it may be better to self manage the risk

Risk identification

There are a number of activities that create business risks but are better self-managed because either they are difficult to quantify, it would not be efficient to use external support or they are 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, gifts and hospitality 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
- 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 RFO in matters of VAT and other taxation issues
- 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

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Insurance

99. All local council employers must take out employers' liability insurance. They should also obtain fidelity guarantee insurance to cover losses from employees. The council should keep under review, all cover to make sure it adequately reflects changes in needs.
100. Adequate insurance against third party risks is vital especially if a local council owns property such as bus shelters, swimming pools and playground equipment.
101. 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.

Chapter 10: Managing investments

This chapter provides guidance on managing long term investments.

What is a long term investment?

102. It is rare for a local council to hold investments other than deposit or other short-term savings accounts. Councils use these short-term investments to maximise income from cash balances during the financial year. They should all be included in the bank reconciliation and line 9 of the accounting statements.
103. 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.
104. A long-term investment is any investment other than one that:
 - 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.

For ease of reference, councils may assume that bank deposits and accounts are classed as short-term investments and are included in line 9 of the accounting statements. Other investments e.g. shares, war bonds and other tradable items whose capital value can change over time are classed as long term investments and are excluded from line 9.

Managing long-term investments

105. 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 6.
106. Long-term investments in assets whose capital values may vary over time carry increased risks and require active management. Because investment management is a specialist area, prudent councils will always seek independent professional assistance when developing their investment strategy and before making decisions.
107. The annual investment strategy will consider whether it is appropriate to retain long-term investments. The strategy will also:
 - set out management arrangements for the investments held;
 - procedures for determining the maximum periods for which funds may prudently be committed; and
 - ensure that the council has properly assessed the risk of committing funds to longer-term investments.
108. Councils should note that it should treat the acquisition of a long-term asset as capital expenditure. Therefore, a council must identify as a long-term asset, all long-term investments, other than in interest bearing accounts. The council treats the initial expenditure as capital expenditure and records the outlay as a payment or expenditure in the year of acquisition.
109. 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

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reserves. 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.

110. When a council receives shares following a de-mutualisation of a Building Society or similar institution this also creates a long-term asset.
111. Chapter 18 provides guidance on how councils account for and report short-term and long-term investments in the annual return.

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Chapter 11: Making payments

This chapter describes the general duty of local councils to make payments in accordance with proper practices. It also sets out the proper practices that local councils should follow.

Proper payments practices – the general duty

112. Local councils must have in place safe and efficient arrangements for managing money to the highest standard of honesty and integrity. These arrangements must include arrangements for handling receipts and payments and for the storage and movement of funds.
113. While protecting assets and the public purse, arrangements should allow local councils to:
- safely upgrade the quality of their funds movements; and
 - take advantage of efficiencies from modern banking methods.

Overview of the guidance

114. The guidance in this section defines proper practices for managing money. It supports local councils in safeguarding the risks to the funds they steward and the services they represent. It:
- defines ‘must’, ‘should’ and ‘may’;
 - defines ‘money’;
 - describes changes to the statutory environment;
 - sets out the legal framework;
 - identifies roles and responsibilities for members;
 - describes corporate arrangements for monitoring and scrutiny; and
 - describes corporate arrangements for managing risk, error and fraud.

Definitions

115. In this section:
- **‘Must’ identifies those requirements that failure to meet represents non-compliance with this proper practice. They are shown in bold type;**
 - ‘Should’ identifies the minimum level of acceptable proper practice. A council applying discretion based on risk assessment can replace ‘should’ requirements with ones that are more demanding; and
 - ‘May’ identifies practices for the council to consider and apply by exercising its discretion.

What is ‘money’?

116. ‘Money’ includes cash and all other forms of negotiable instrument and stores of value that can easily be converted into cash. For example, a non-exhaustive list of money includes:
- physical cash and notes, petty cash and unclaimed receipts, imprest accounts, cash in transit;

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- unpaid income held by debtors;
 - signed and unsigned cheques, drafts and other orders for payment;
 - current, deposit and investment accounts at banks and financial institutions and access to undrawn borrowing facilities;
 - credit cards (where held – see below), debit cards, store cards, fuel cards;
 - access to balances by telephone or electronic transfer; and
 - the ability to buy goods or services on credit.
117. Where any doubt exists over what constitutes money, councils should presume that it is within the scope of the definition. The definition covers all accounts held with financial institutions and controls over access whether physical or electronic.

Changes to the statutory environment

118. Councils have to respond to two key changes in the statutory environment for payments by local councils.
119. Firstly, the Payments Council set out a strategic vision for UK payments in 2008. The plan accepts the long-term decline in the use of cheques and sets 2018 as a target closure date for cheque clearing. After this date, banks will no longer issue or clear cheques. Local councils therefore need to identify safe and efficient alternative methods of payment for goods and services.
120. Secondly, the government has indicated that it will repeal Section 150(5) of the Local Government Act 1972. This legislation governs the stewardship of money by local councils. It requires that ‘every cheque or other order for the payment of money shall be signed by two members of the council’.
121. While supporting progress, central government expressed concern that ‘the removal of S 150(5) should not leave the public funds controlled by parish councils at any greater risk of loss through misconduct or poor control.’ It required that ‘safeguards be put in place (so) that all the payments made by parish councils are legitimate and that there is no misuse of the system.’ This requirement equally applies to community councils in Wales.

The roles and responsibilities of the Responsible Financial Officer

122. The law requires every local authority to arrange for the proper administration of its financial affairs and that one of its officers has responsibility for those affairs. This officer is the Responsible Financial Officer (RFO).
123. Even where a local council has not made a formal appointment, there is always a council RFO in all circumstances. By default, the RFO is the person responsible for keeping the accounts. The council should appoint a temporary RFO if the appointed RFO is unavailable through absence or illness.
124. The RFO should be familiar with statutory duties for the financial administration and stewardship of the local council which arise from:
- Sections 114 and 151 of the Local Government Act 1972;
 - The Local Government and Housing Act 1989; and
 - The Accounts and Audit (Wales) Regulations 2005 (as amended) (‘the Regulations’).
125. The responsibilities of the RFO for managing money are to advise the council on:
- the corporate financial position;
 - the key financial controls necessary to secure sound financial management; and

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- its treasury (that is cash and investments) management.

The roles and responsibilities of members

126. **Good practice must underpin proper arrangements to protect public money. Councils must review their effectiveness regularly to identify and protect against possible risks.**
127. A local council's members are jointly and individually responsible for putting proper governance arrangements in place to safeguard public funds. Councils may delegate the role of protecting its money to individuals, for example to the Clerk or the RFO. However, the legal responsibility always remains with the council and its members.
128. Arrangements should demonstrate how the council intends to meet its responsibilities within the legal framework. They should be current and include the specific duties and responsibilities of named individuals for securely managing money and arranging its security, as well as for identifying internal controls and supervision measures.
129. The council may seek external advice and guidance if it does not have sufficient or appropriate internal expertise or knowledge. Reviews of arrangements may be carried out by members or by Internal Audit.

Corporate arrangements for monitoring and scrutiny

130. **Councils must identify and protect all sources and forms of income and expenditure and the money represented by each. They must ensure that controls over money are embedded in Standing Orders and Financial Regulations.**
131. **Councils must not relinquish the 'two member signatures' control over cheques and other orders for payment until section 150 (5) has been repealed and they have put in place safe and efficient arrangements in accordance with this guidance.** The 'two member signatures' control is just one of many possible controls but by itself it is unlikely to meet the requirements of the general duty of care.
132. **The council must approve the setting up of and any changes to all accounts with banks or other financial institutions.**
133. **A decision to enter a 'pooling' or 'sweep' arrangement whereby the bank aggregates the council's various balances daily to minimise interest costs, must be approved by the council.**
134. **Where held, corporate credit card accounts must be set up to operate within a limit set by the council and must be cleared monthly by direct debit from the main bank account.**
135. The council should approve the bank mandate, including the list of authorised signatures and the limits of authority on each account as well as any amendments. Where multiple accounts are held, authorised signatures should not be allocated to just a few members; sharing responsibility adds to control. Authorised signatories should be rotated.
136. Internal controls set out within Financial Regulations should include the temporary holding, transit and permanent storage of money.
137. Councils should set out clearly in writing the responsibilities of officers and their managers in relation to money. Where employees have responsibilities for collecting money or making payments, their terms and conditions of employment should include adherence to internal controls, including any updates. Officers should acknowledge in writing they have understood these special responsibilities and received appropriate training.

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138. When recruiting officers to be responsible for money and funds management, or when choosing members to be controlling account signatories, councils should consider a Criminal Records Bureau (CRB) check before appointment and periodically thereafter. Any decision not to carry out a CRB check should be clearly documented.
139. Councils should avoid the use credit cards as they do not meet minimum money control standards and present unacceptable and unnecessary risks to public funds.

Corporate controls to manage risk, error and fraud

140. **Risk assessment and internal controls must focus on the safety of the council's assets, particularly money. Councils must practice a clear segregation of duties regarding money and its movements.**
141. **Councils must be constantly vigilant and avoid complacency about managing money.**
142. Members should keep themselves informed so that they can address known risks and threats to money. Councils may engage with the police and local anti-fraud and corruption networks to keep up to date with risks and security threats.
143. Insurance is an important tool in any security plan. Fidelity Guarantee or any other form of insurance over threats to money is not by itself acceptable protection for the council's funds. Insurance should always be adequate to cover risk exposure. Insurers do not, as a rule, pay claims where internal controls are inadequate or unenforced. Police investigations are hampered and prosecutions weakened by lax controls over vulnerable assets.
144. The council should insist on accurate record keeping of transactions by regular review. Rotation of responsibilities should be practiced to avoid familiarity.
145. Members should always be aware where their money is and who has access to the funds they are responsible for. A listing of all accounts held, their current authorised signatures and their current balances should be available for members in the form of bank reconciliation. Councils should expect to see a bank reconciliation produced by the RFO at every council meeting. In the event of bank reconciliation discrepancy, explanations should be checked and verified independently. A failure to produce a bank reconciliation indicates a possible threat to financial resources.
146. Transfers between bank accounts are excluded from bank reconciliation but should be subject to the same authorities and controls as other payments and receipts. Therefore, a listing of non- 'pooled' or 'swept' inter account transfers made during the year should be maintained and made available to members or auditors on request.
147. Councils may from time to time wish to ask banks and other institutions holding the council's funds for written confirmation of balances. This should be sent to a named member who is not an authorised signatory. This is a particularly important control where paper statements are not received and reliance is placed on electronic information.
148. The RFO should issue any cheques or other orders for payment immediately after approval by the council. Cheques approved for payment by the council but held back by the RFO are not only vulnerable to theft or misappropriation but can result in an over-optimistic view of available financial resources.
149. Trade credit arrangements with local suppliers should be cleared monthly. This not only meets government targets on proper payments procedures by local government bodies but also supports local businesses that should not be called on to finance local councils.