



# Governance and Accountability in Internal Drainage Boards in England

A Practitioners' Guide 2006

Revised November 2007



**Association of Drainage  
Authorities**



## Acknowledgements

This is the first edition of the Practitioners' Guide for Internal Drainage Boards and is the result of work overseen by a project group with membership drawn from key stakeholders. This Guide will need to be kept up to date with developments relevant to Internal Drainage Boards. The Internal Drainage Boards Joint Advisory Group (IDB JAG) was formed in April 2004 as a standing group with members drawn from key stakeholders, to help ensure that the guidance remains relevant to the needs of Internal Drainage Boards and is updated as appropriate.

The members of the Internal Drainage Boards Joint Advisory Group are:

Mike Barnes	Audit Commission (Chair)
David Noble	Association of Drainage Authorities ( <i>until 31/12/2005</i> )
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## Preface

### **Good governance, accountability and transparency are essential to Internal Drainage Boards and a cornerstone of the government's approach to modernising public services.**

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.

In discharging this accountability, public bodies and their management (both members and officers) are responsible for putting in place proper arrangements for the governance of their affairs and the stewardship of the resources at their disposal. They are also required to report on their arrangements in their annual published Statement on Internal Control.

As a safeguard to ensure the proper discharge of this accountability, external auditors in the public sector give an independent opinion on public bodies' financial statements. They may also review, and report on, aspects of public bodies' arrangements to ensure the proper conduct of their financial affairs and to manage their performance and use of resources.

This publication has been prepared in response to the need for a clear statement on 'proper practices' for both day-to-day practitioners - users and trainers alike - and auditors, internal and external. It is a guide to the accounting practices to be followed by Internal Drainage Boards and sets out the appropriate standard of financial reporting to be followed. It is intended to represent 'proper practice' as referred to in the Accounts and Audit Regulations.

We are committed towards making this guidance as useful, complete and 'user friendly' as possible, but there will always be scope to improve. As it is our intention to issue updated versions of this guidance from time to time, there is a continuing opportunity to keep it up to date, identify and share good practice and respond to the needs of Internal Drainage Boards. If you have comments or suggestions as to how to improve this guidance, please send these to 'Practitioners' Guide' at The Association of Drainage Authorities, 12 Cranes Drive, Surbiton, Surrey, KT5 8AL or to the Flood Management Division (FM), Department for Environment, Food and Rural Affairs, 3B, Ergon House (LER), Horseferry Road, London SW1P 2AL .

## Introduction

1. The purpose of this guidance is to help practitioners to understand regulatory requirements faced by Internal Drainage Boards. It provides a guide to the accountability and audit framework being introduced in 2006 and looks at how risk management, principles of good internal control and the roles of the internal and external auditors apply to Internal Drainage Boards. The aim is to provide a source of information about accounting and audit matters as they affect Internal Drainage Boards, and is intended to be used not only by practitioners, but also by elected members and officers, accountants, internal auditors and trainers.
2. From 1 April 2006, the public accountability and financial reporting requirements set by Defra for the majority of Internal Drainage Boards may be met by completing a single document. The Audit Commission and Defra have made this possible by designing a return that combines the statutory statements of accounts and internal controls with the statutory annual report. This innovation will significantly reduce the regulatory burden on Internal Drainage Boards but requires co-operation by Boards in bringing forward their financial year-end timetable.
3. The accountability and audit framework applies to all Internal Drainage Boards. There are, however, different formal reporting requirements for those with annual expenditure or annual income below and above a threshold set by law<sup>1</sup>. The majority of Internal Drainage Boards will complete an annual return. The largest Internal Drainage Boards will continue to prepare a statement of income and expenditure and a balance sheet as well as completing a separate annual report to Defra.
4. The guidance is structured as follows:
  - **introduction** and background to the new arrangements;
  - **part one** covers the legal framework within which Internal Drainage Boards and their auditors must work. This is supported by Appendix 1, which summarises the legislation applicable to Internal Drainage Boards;
  - **part two** provides guidance on the annual return and corporate governance. This takes practitioners through each of the sections of the new annual return and provides guidance on good practice;
  - **part three** focuses on accounting guidance aimed at promoting good practice when preparing the statement of accounts. It also provides

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<sup>1</sup> The value of the threshold amount may be found in the Accounts and Audit Regulations. At the time of writing the threshold stands at £1,000,000

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guidance on the management accounts and records that support good accounting, including in relation to accounting for specialist assets; and

- **part four** provides guidance to the largest Internal Drainage Boards

A glossary of words and phrases commonly used is included at the end of this guidance.

5. This document is intended to be a working tool for Internal Drainage Boards. It is not a comprehensive guide to all aspects of the law applicable to Internal Drainage Boards. Nor can the guidance cover all queries about the application of the accountability and audit framework as this develops over time. Arrangements have, therefore, been put in place to provide a technical support network through the Association of Drainage Authorities (ADA) who are themselves supported by regular meetings of a Joint Advisory Group made up of practitioners and representatives from the Chartered Institute of Public Finance and Accountancy (CIPFA), the Audit Commission, the Department for Communities and Local Government (DCLG, formerly ODPM), the Department of the Environment, Food and Regional Affairs (Defra) and the audit suppliers. These arrangements are intended to provide sources of further support and guidance, and, from time to time, the guidance in this document will be updated and revised as appropriate.
6. This guidance is intended to cover the annual return for Internal Drainage Boards. The form and content of the **annual report** to Defra may change from year to year. Guidance on completing this section is not included here but will be issued to IDBs together with the annual return.

## Background

1. Since 2004, the Audit Commission working with the national representative body for Internal Drainage Boards, the Association of Drainage Authorities (ADA) and the sponsoring Government Department, Defra, has examined whether a limited assurance approach to the external audit, drawing on their experience of developing such arrangements for local councils, may be suitable for Internal Drainage Boards. The steering group referred to in the acknowledgements, carried out sufficient work to gain assurance for those responsible for determining the shape and scope of the formal accounting and audit approach for public bodies to approve the application of such an approach for the majority of IDBs.
2. This guidance states in a practical way, the current requirements of legislation and the responsibilities of the various parties involved. It explains the processes and decisions that need to be carried out to comply with statutory requirements, provides examples of how this may be achieved, and builds on the good practices currently being employed. It comes into effect for the audit of accounts for years ending on or after 31 March 2006.
3. This approach relies to a significant extent on self-certification by Boards that their internal arrangements are being maintained at a level consistent with good practice. This requires the active participation of elected and appointed members in the process of providing positive public assurance that their stewardship of the publicly owned assets with which they have been entrusted has been properly managed. Although Boards have always provided some assurance through approving the annual accounts, members need to provide a written statement of assurance. Board members, working as a corporate body, will need to be able to provide assurance with confidence, based on adequate information about the operation of internal controls within their Boards.
4. The accountability and audit framework is 'risk-based'. It must be proportionate to risk, to the amounts of public money involved and to stakeholders' need for assurance. Whilst the limited assurance external audit approach provides a lower level of assurance than that which preceded it, it remains responsive to the need to safeguard the proper conduct of public business. External audit remains an essential element in accounting for public money and makes an important contribution to the stewardship of public resources and to the corporate governance of public services. It also supports local democracy by helping to ensure that the members and officers are accountable to the communities they serve and by providing assurance that public money has been properly spent.





## Part 1

### The legal framework for Internal Drainage Boards in England and Wales

This part of the guidance describes the nature of Internal Drainage Boards and the legal framework within which they operate. It also covers the development of the new audit approach and the annual return approach to statutory reporting.

#### What are Internal Drainage Boards?

- 1.1 *'Internal Drainage Boards are independent bodies created under land drainage statutes, which can trace their ancestry in some cases back to the 13<sup>th</sup> century. There are around 200 such Boards in England concentrated in the lowland areas of East Anglia, Somerset, Yorkshire and Lincolnshire where there are special drainage needs. Many of the Boards operate as consortia of which there are 65. They have permissive powers to undertake flood defence works, other than on main rivers, in a defined geographical area. Each Board includes those elected by and representing the occupiers of land in the area and members nominated by the local authorities in that area. Internal drainage Boards secure income mainly from drainage levies on farmers and other occupiers and from special levies on local authorities. They must also pay levies to the [Environment] Agency to fund works on main rivers that protect internal drainage Board areas.'* (taken from 'Inland Flood Defence' - NAO HC299 15 March 2001)
- 1.2 The constitution of Internal Drainage Districts and membership of most Internal Drainage Boards is governed by Section 1 of the Land Drainage Act 1991 (the Act) which consolidated all previous enactments relating to such Boards and of local authorities in relation to land drainage.
- 1.3 Internal drainage authorities are of several kinds. The majority are Boards for internal drainage districts constituted by order of the Environment Agency or its predecessors. Others may be bodies that existed before 1930 and were either:
  - a) Commissioners of Sewers constituted by Commission issued under Statute of Henry VIII or the Land Drainage Act 1861;
  - b) Elective drainage Boards constituted by Provisional Order under the Land Drainage Act 1861; or

c) Bodies created by local or private Acts of Parliament. These bodies were not governed by the general statutes affecting sewers and land drainage enacted before 1930. They have various titles, frequently 'Drainage Commission' Of these old bodies, such as had drainage districts constituted under earlier enactments were deemed for the purposes of the Land Drainage Act 1930 to have been constituted thereunder. Other bodies fell within the definition 'drainage authorities'.

- 1.4 The role of all these bodies is, however, similar and it is appropriate that a common accounting and audit framework applies to them all.
- 1.5 The abolition of domestic rates in 1990 necessitated changes in the basis of assessing non agricultural drainage rates and this was achieved through various Acts and Instruments. In summary, the expenses of non-agricultural land drainage are met by special levies issued in accordance with regulations made under s75 of the Act to 'billing authorities' areas wholly or partly included in the Board's district. In practice, the term 'billing authorities' refers to District, Borough, Metropolitan and Unitary councils in England.
- 1.6 Other changes brought about by the abolition of domestic rates, and of the distinction between owners and occupiers, required a new approach for assessing agricultural drainage rates. From 1993 an Internal Drainage Board may make a drainage rate in respect only of agricultural land and agricultural buildings which is levied on the occupiers of non-urban property (referred to as a hereditament) in the district. If the property is unoccupied, the owner shall be deemed to be the occupier.
- 1.7 The proportion of expenses raised by rates and special levies is regulated; the powers of, and conditions attached to, issuing and collecting special levies are set out in section 37 of the Act and governed by Section 75 of the Local Government Finance Act 1988 and the Internal Drainage Boards (Finance) Regulations 1992.
- 1.8 The national sum of Special Levies raised by Boards is a feature of the calculations made by the Treasury each year in determining the amount of Regional Support Grant Paid to billing authorities. Making arrangements for the accurate and timely reporting of special levies to Defra is therefore an important responsibility for each Internal Drainage Board.
- 1.9 Internal Drainage Boards are bodies corporate formed by statute and therefore may only do that which they are empowered to do by law.

Anything else, no matter how apparently justifiable or useful, will be beyond the powers of the Board ('ultra vires').

- 1.10 Although there is considerable interaction between Boards and local authorities, it is not correct for Internal Drainage Boards to be described as Local Government Bodies as, with a few notable exceptions, local government legislation does not apply to them. Boards are, however, subject to the requirements of the Audit Commission Act 1998 and the Accounts and Audit Regulations issued from time to time under that Act.

### **Roles and responsibilities within Internal Drainage Boards**

- 1.11 Apart from the first members of an internal drainage Board, members are either elected or appointed by charging authorities.
- 1.12 Elections are held triennially in accordance with rules made by the Minister. The electors comprise those persons who at the date of the election occupy land in the Board's district on which a drainage rate has been levied in the year immediately preceding.
- 1.13 Each elector has a number of votes according to the assessable value of the property occupied and may not be eligible to vote if at the date of the election his drainage rates are unpaid. Similarly there are property qualifications for election as a member and a person may not be qualified if his drainage rates have remained unpaid for more than one month at the date of the election. Undischarged Bankrupts must cease to be members.
- 1.14 The Council Tax billing authority for any area wholly or partly included in an internal drainage district may appoint a member or members of the Board having powers to issue special levies to it. The number of appointed members to the Board shall not exceed by more than one the number of other (i.e. elected) members of the Board. Otherwise, the number of appointed members must bear the same ratio to the maximum number of members as the expenses to be raised from special levies bears to the total expenses of the Board.
- 1.15 It is the responsibility of the Internal Drainage Board to ensure that arrangements are in place such that its 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, but certain individuals have specific responsibilities.

- 1.16 Officers may be appointed and paid, and there is usually nothing to prevent the appointment of a member as a paid officer. Such practice is, however, generally discouraged as it may create an inappropriate lack of proper separation of responsibilities, particularly if a member is charged with responsibility for the finance management function. Employees of drainage Boards may be made superannuable by a resolution of the Board and become eligible to join the Local Government Pension Scheme.
- 1.17 Most Internal Drainage Boards will employ a clerk to oversee the administration of their affairs, including managing the Board's finances. There is no parallel requirement in the Act which is equivalent to section 151 of the Local Government Act 1972 which requires local authorities to appoint a responsible financial officer (RFO) to manage their financial affairs. Boards should, however, make such an appointment in order to avoid any confusion about who is responsible for setting out accounting arrangements and preparing the Board's accounts in accordance with proper practices, particularly as the Accounts and Audit Regulations contain a number of references to the responsibilities of such an officer or person.
- 1.18 As an employer, the Board has the same duties and responsibilities, including the operation of PAYE, as any other employer.
- 1.19 It is the Board as a whole, however, that is responsible in law for ensuring that corporate financial management is adequate and effective and that the Board has a sound system of internal control which facilitates the effective exercise of their functions, which includes arrangements for the management of risk. All Internal Drainage Boards are required to conduct a review at least once a year in accordance with proper practices of the effectiveness of their system of internal control, and publish a report on the outcome of the review. The internal audit function will be helpful in this respect by reporting to the Board on the state of their internal controls.
- 1.20 Practitioners may wish to refer to a helpful booklet produced by the Audit Commission entitled *Statement of responsibilities of audited bodies and their auditors* which describes the relationship between Internal Drainage Boards and their external auditors. It seeks to clarify where the different responsibilities of the local Board and its auditor begin and end. This booklet is reproduced at Appendix 2.

## **The role of the Environment Agency**

- 1.21 The Environment Agency has flood defence powers in relation to main rivers and the sea. It carries out its flood defence function through its Regional Flood Defence Committees (RFDC). The Environment Agency also has a duty to exercise a general supervision over all matters relating to flood defence in England and Wales. The Environment Agency receives the majority of its funding direct from Defra in England and WAG in Wales, in the form of Flood Defence Grant-in-Aid. It also raises a precept on IDBs and local levies on local authorities.
- 1.22 In the Anglian, Southern and Environment Agency Wales regions the RFDCs are also the IDB for a part of their flood defence district. IDB business is carried out at meetings convened for that purpose not at RFDC meetings.

## **The Audit Commission and the development of the limited assurance audit approach and the annual return**

- 1.23 A key feature of the audit approach which comes into effect for financial years commencing on or after 1 April 2006, is that it seeks to recognise the differing circumstances of Boards of different size. This is described in the flowchart at Appendix 3.
- 1.24 This guidance is targeted towards meeting the needs of practitioners within Internal Drainage Boards. However, the following paragraphs may be helpful as background to the development of the audit approach. Extracts from the Audit Commission's *Code of Audit Practice* can be found at Appendix 4 and 'key elements of the Commission's guidance to external auditors' is reproduced at Appendix 5.
- 1.25 The Audit Commission is an independent body with statutory responsibilities to regulate the audit of local government in England and Wales. The Commission's *Code of Audit Practice* (the Code) sets the required standards for its appointed auditors. The Code, when talking about how auditors should discharge their statutory annual audit duties at Internal Drainage Boards, states:

*"Internal Drainage Boards demonstrate the proper discharge of their responsibilities by preparing, and providing the auditor with, the accounts prepared for the financial year, together*

*with such additional information and explanation as is necessary to provide sufficient evidence that they have maintained adequate systems of internal control and internal audit throughout the financial year”.*

- 1.26 Working with the Commission, the representative bodies for Internal Drainage Boards and their clerks, responsible government departments in both England and Wales and the public sector accounting professional body, CIPFA, undertook to develop a simple approach to meeting this legal responsibility which could be:
- easy to prepare and be easily understood by readers;
  - subjected to an appropriate level of external audit without the need for lengthy preparation and inconvenience; and
  - cost efficient.
- 1.27 The outcome was the annual return, a copy of which is attached as Appendix 6. For accounting years ending 31 March 2006 and thereafter, completion of the annual return by Internal Drainage Boards where annual income or expenditure is £1,000,000 or less is a requirement under Section 9 (3) of the Accounts and Audit Regulations 2003 as amended.
- 1.28 Part 2 of this guidance considers the annual return in more detail, but some general points about this approach should be noted.
- 1.29 The external audit approach described above relies heavily on the co-operation of the Board with the external auditor and a significant amount of self certification by the Board. The corporate governance arrangements within the Board must be demonstrably sound and the annual return is expected to be accurate and complete when presented to the auditor.

#### **‘Proper practices’**

- 1.30 The Accounts and Audit Regulations 2003 as amended refer in a number of places to the need for Internal Drainage Boards, in fulfilling the requirements of the Regulations, to follow ‘proper practices’. In the guidance which accompanies the 2003 Regulations (reproduced here as an annex to Appendix 7), DCLG (formerly ODPM) explains the source of the term proper practices, its legal standing and where they may be found. In the case of Internal Drainage Boards it is this publication, *Governance and Accountability in Internal Drainage Boards in England and Wales – a Practitioners’ Guide*, in which may be found the proper practices referred to in the Regulations.

## 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.**

**During the development of the new approach, the Audit Commission identified a need to provide Internal Drainage Boards with more guidance on risk management, internal controls and the role of the internal auditor. Understanding these, and their interrelationship, is key to good governance and the proper completion of the annual return, and thus to the success of the new approach. They are covered in this part of the guidance.**

**Part 2 of the guidance is structured as follows:**

- **what is the annual return?**
- **the accounts;**
- **explaining significant variances and analytical review;**
- **bank reconciliation in support of the annual return**
- **the statement of assurance;**
- **the external auditor's certificate and opinion;**
- **the internal auditor's annual report; and**
- **risk management.**

#### What is the annual return?

- 2.1 The annual return (see Appendix 6) is a document with several purposes:
- to report the annual accounts as approved by the Board;
  - to certify that the Board 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 Board has been doing during the last financial year; and
  - to be a source of information for Government and other stakeholders about the activity of Internal Drainage Boards.

- 2.2 The annual return is in four sections:
1. the accounts;
  2. the statement of assurance;
  3. the external auditor's certificate and opinion; and
  4. internal audit's report.
- 2.3 The first three of these sections are intended to be made publicly available and the return itself has been designed as one clearly integrated document to make display as simple as possible.

### **The accounts (section 1 of the annual return)**

- 2.4 The annual return, which is the Board's statutory statement of account, must be signed by the person identified by the Board as the person responsible for the financial management of the Board (referred to in this guidance and in Regulations as 'the RFO'). This person will certify that it presents fairly the financial position of the Board at the end of the year to which it relates and its income and expenditure, or that it properly presents receipts and payments, as the case may be (see paragraph 2.6 below), and that it is consistent with the Board's underlying financial records.
- 2.5 This means that, by signing the certificate, the Board's RFO is satisfied, and can if requested demonstrate, that the accounting procedures, which have been determined by the RFO, have been observed throughout the year and that the supporting financial records of the Board are maintained in accordance with proper practices and kept up to date.
- 2.6 Current rules require Internal Drainage Boards where the gross income or expenditure (whichever is the higher) for the year has exceeded the threshold of £200,000 for a period of three continuous years, to report their financial details on an income and expenditure basis, from the third year onwards. In part 3, detailed guidance is given, together with examples, of the methodology to be employed at year-end to convert a receipts and payments account into an income and expenditure account.
- 2.7 Internal Drainage Boards operating below the £200,000 threshold may choose to report either on an income and expenditure basis or on a receipts and payments basis. However, Boards which change the basis on which their accounts are presented should ensure that the two years' comparative accounts in the annual return are shown on a consistent basis and any change in the way that the accounts



are presented, i.e. from income and expenditure to receipts and payments (or *vice versa*) is noted on Section 1 of the return and has been explained by means of a note to the auditor.

- 2.8 The Board itself is also asked to give a public assurance (see next section) that in approving the annual statement of accounts it is satisfied that this has been prepared in accordance with the requirements of the Accounts and Audit Regulations 2003 as amended and that proper practices have been complied with. As with all other decisions made by the Board, all of which have a legal implication, members have a duty to make themselves familiar with the requirements contained in the Regulations.
- 2.9 Alongside the RFO's certification, the person presiding at the committee or meeting at which approval to the statement of accounts is given, is required to confirm, by signing the accounts page of the annual return, that the accounts have been approved by the Board in accordance with the Regulations. Currently these require the accounts to be approved "as soon as reasonably practical and in any event within three months after the end of the period" to which the statement of account relates. The intention behind the requirement for the chair of the committee or meeting to sign and date the statement of accounts is that the chair's signature should formally represent the completion of the Board's approval process of the accounts.
- 2.10 In practical terms, as the financial year-end for Internal Drainage Boards is 31 March in any year, the accounts have to be approved by the following 30 June. However, the further the distance between the year end and the accounts approval and publication date, the less useful the accounts are to the reader. The statutory approval date of 30 June should be considered, therefore, the latest date by which this can be given. It is good practice to complete the accounts, and have them approved by the Board 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 Internal Drainage Boards into a simple, easy to read format. For the benefit of both the compiler and the reader, each of the ten line items carries a note of explanation 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 Board for which additional fees may be incurred,

- 2.13 All figures in the annual return should agree to the primary financial records of the Board. 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 Board to the external auditor, is an explanation of significant variances in levels of expenditure and balances. This requirement may prompt a number of questions by practitioners who are not used to reviewing financial information in this way.
- 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 Board 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 Board to help answer this question
- 2.18 It is also good practice for Internal Drainage Boards 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 Board 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 rates of say 20% which is not matched by a corresponding increase in expenditure requires an explanation. Conversely, a 50% rise in the rates 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 pumping station some time in the future, 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 rates 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%-15% and greater will almost certainly require a formal explanation.
- 2.23 Balances that move to or from zero will generally require an explanation. As most expenditure by Internal Drainage Boards 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 does not equal Box 8, this difference must be explained. This difference should only occur in cases where the Board’s accounts are presented on an income and expenditure basis, and the explanation is most commonly the effect of debtors

and creditors in the Board's balance sheet. It should be possible to provide the auditor with details of the year-end debtors and creditors showing how the net difference between them is equal to the difference between Boxes 7 and 8.

- 2.25 As Boards have no legal powers to hold reserves other than those for reasonable working capital needs or for specifically earmarked purposes, whenever a Board's year-end reserves are significantly higher than the Board's annual rates, an explanation of their make up should be provided.
- 2.26 From the figures provided in the statement of accounts, the external auditor is able to carry his or her own analytical review in order to improve his or her knowledge of the Board, gain some assurance about consistency and so plan the audit work accordingly.

### **Bank reconciliation in support of the annual return**

- 2.27 The submission of the annual return must also be accompanied by a copy of the Board's year-end bank reconciliation. The bank reconciliation, which must cover all bank accounts held by the local Board, is a key tool for management's assurance that the Board'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 Board incurring additional audit work and cost which could otherwise be avoided. Further information on performing bank reconciliations is in Part 3.
- 2.28 In cases where a Board holds investments in institutions that are not banks or in securities, these should be noted on the bank reconciliation presented so that the auditor may confirm the balances shown in line 8 of the statement of accounts section of the annual return - total cash and investments.

### **The statement of assurance (Section 2 of the annual return)**

- 2.29 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.
- 2.30 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.

- 2.31 Boards are expected to make eight representations or assertions, which together comprise a statement of assurance about the accountability of the Board. These are covered in the following paragraphs. Each of the representations to be made is quoted in italics before a brief explanatory note.

1 *“we have approved the accounts which have been prepared in accordance with the requirements of the Accounts and Audit Regulations and proper accounting practice”*

- 2.32 This first assurance statement covers the published accounts of the Board. Through the act of formally approving the accounts the Board asserts that it has prepared those accounts in the way prescribed by law.

2 *“we have maintained an adequate system of internal control, including measures designed to prevent and detect fraud and corruption, and reviewed its effectiveness”*

- 2.33 This second representation covers the local Board'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.

- 2.34 It is the Board's responsibility to define, introduce and maintain internal controls to protect the asset stewardship and service delivery responsibilities it must deliver. These controls are critical to the Board's functions and should be periodically reviewed, at least once a year.

- 2.35 A more detailed discussion of internal controls, which auditors may wish to test, can be found in the section on risk management which starts at paragraph 2.63 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 Board to conduct its business or on its finances”*

4 *“we have provided proper opportunity for the exercise of electors’ rights in accordance with the requirements of the Accounts and Audit Regulations”*

2.36 The third and fourth representations cover the local Board’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. These arrangements include providing the opportunity for electors to exercise their rights to inspect the financial records and ask questions of the auditor in relation to them. The representations confirm that the Board has only done things that it has the legal power to do, has allowed all persons who may be interested the opportunity to exercise their rights and has conformed to 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 Board and taken appropriate steps to manage those risks, including the introduction of internal controls and/or external insurance cover where required”*

6 *“we have maintained an adequate and effective system of internal audit of the Boards accounting records and control systems”*

7 *“we have taken what we consider to be appropriate action on all matters raised in previous reports from the internal and external auditors”*

2.37 These fifth, sixth and seventh representations cover a local Board’s responsibility to develop and implement systems of internal control (see risk management section below), including systems of internal financial control, and to put in place proper arrangements to monitor their adequacy and effectiveness in practice, 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 of control procedures.

8 *“we are not aware of any litigation, liabilities or commitments, events or transactions, occurring either during or after the end of the financial year being reported, other than those included in the accounts”*

- 2.38 The eighth and last representation covers the local Board's responsibility to conduct its financial affairs properly and to put in place proper arrangements to ensure that its financial standing is soundly based. This representation provides assurance that the local Board has considered and disclosed 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.

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

- 2.39 The external audit is 'opened' by the auditor appointing a date for the exercise of rights of electors (see Accounts & Audit Regulations 2003, regulations 13-16 in Appendix 7). The issue of a certificate of completion by the external auditor effectively concludes and 'closes' the audit process for any given year.
- 2.40 A local Board 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. It is a common practice for the accounts and the external auditor's certificate to be displayed alongside this notice. The annual return is designed to make the display easy.
- 2.41 The auditor's formal report recognises the relative statutory responsibilities of the Board 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 Board and then give his/her opinion on it.
- 2.42 The auditor's report contains an opinion on the accounts. It must state the basis on which the opinion was 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 Internal Drainage Boards operating at or below the £1,000,000 threshold. The internal controls and other governance arrangements which are expected to be maintained by Internal Drainage Boards means that the amount of work required from external auditors to fulfil their statutory duty can be correspondingly reduced to a proportionate level.

- 2.43 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 evidence required in relation to the accounts or the statement of assurance, or the information presented means that the auditor cannot give an unqualified opinion, then the auditor will report this as an exception to the opinion within the audit report. Assurance statement 7 by the Board should include consideration of actions taken in response to any auditor opinion qualifications that may have been raised in previous years.
- 2.44 Auditors may also draw the Board's attention to matters without qualifying the opinion. Such events are recorded in a separate section of the auditors report.
- 2.45 If internal controls within Internal Drainage Boards are inadequate, there is an increased risk of error, mistake and fraud. Internal Drainage Boards should consider this as part of risk management arrangements (see below).

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

- 2.46 The purpose and role of internal audit has the potential to be the one most misunderstood by practitioners. We have, therefore, addressed this function in some detail in this section of the Practitioners' Guide in order to assist practitioners and members in determining how best they may approach the subject in order to meet their statutory obligations.
- 2.47 Regulation 6 of the Accounts and Audit Regulations 2003 as amended imposes a duty on Internal Drainage Boards 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'. Proper practices in relation to internal audit for Internal Drainage Boards may be found in this Practitioners' Guide.
- 2.48 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 Board 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 Board.



- 2.49 Having established what internal audit is and what its relationship with the Board should be, it is important for Boards to consider whether the internal audit is proportionate to the needs, the size and the circumstances of the Board.
- 2.50 Each Board sets out its control objectives, usually in the form of standing orders and/or financial regulations. The smaller the Board, the less onerous these need to be. Similarly, the scope of internal audit at smaller Boards will be correspondingly less than at larger ones. The more complex the Board is or becomes, in terms of its organisation and range of activities, number of employees, etc. the wider ranging the scope of internal audit should be.
- 2.51 It is a matter for the Board 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 Board. There is now considerable practical experience among other bodies 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 secretary of the ADA branch in your area.
- 2.52 Internal Drainage Boards may secure internal audit in various ways and a range of options is given below [see box]. As stated above, it is for each local Board to determine how best to meet the legal requirement for an internal audit having regard to its own business needs and circumstances.

**Internal Drainage Boards may secure an internal audit in various ways including:**

- appointing a local individual or a member of a panel of individuals administered by a local branch of the ADA. An individual will need to demonstrate adequate independence and competence to meet the needs of the local Board;
- engaging an officer or member from a neighbouring Board or local government body
- employing a competent internal auditor with sufficient organisational independence and status to undertake the role;
- purchasing an internal audit service from one of the principal local authorities in the Drainage Area;
- 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 Internal Drainage Boards a specialist contractor appointment may be appropriate.

- *For practical examples of how Internal Drainage Boards may secure internal audit see paragraph 2.58 below*

- 2.53 Internal Drainage Boards 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 Internal Drainage Boards must ensure are met by their internal audit function, regardless of how procured. These principles are independence and competence.
- 2.54 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 Board, i.e. the Boards financial controls and procedures. It follows, for example, that the circumstances in which a member of a Board can demonstrate that they are sufficiently independent of the financial decision making and procedures of the Board are difficult to envisage, since such a member would need to exclude themselves from key financial decisions by the Board in order to maintain their independence.
- 2.55 Similarly, it would not be appropriate for any individual or firm appointed by the Board to assist them with their accounting, preparation of financial statements or the annual return to be also 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.
- 2.56 Those charged with carrying out internal audit should not be asked to offer consultancy or advice on the Board'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 Board.
- 2.57 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 auditor 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 the accounting requirements within the legal framework and powers of Internal Drainage Boards.

2.58 There are a number of practical examples of how Internal Drainage Boards may source their internal audit service learning from the local councils' case study below. This section of the guidance will be updated when IDBs and ADA have added to these solutions.

***Local councils in England have benefited over recent years from a number of innovative and creative solutions that have been developed by NALC County Associations, SLCC branches and local councils themselves for sourcing internal auditors at reasonable cost:***

- local panels of members who are no longer able to carry out the internal audit function at their individual councils<sup>1</sup>;
- local panels of officers (usually clerks) providing internal audit services to each other and sometimes wider afield<sup>1</sup>
- 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 operate community development policies which encourage their officers to take part in community activities – they are not permitted to charge for this service)
- local business owners and managers – a number of larger corporations have policies similar to the banks with regard to community action
- independent examiners for local charities
- specialist internal audit service providers operating on a fixed fee or on an hourly rate
- consortia organised by the local NALC or SLCC branch (or sometimes in partnership) providing affordable internal audit
- individuals identified by NALC or SLCC acting under their quality controls to provide internal audit services to local councils

*Additionally, in a very positive and welcome development, a number of district councils have offered, under their community development budgets, to provide training and support for potential internal auditors for local councils and may be willing to do so for local Internal Drainage Boards.*

<sup>1</sup> Subject to the guidance that one to one reciprocal arrangements between Boards are unlikely to be seen as being sufficiently independent to satisfy this requirement

2.59 The duties of internal audit relate to reporting to the Board on the adequacy of its systems of control. The internal auditor's annual report is section 4 of the annual return but the guidance given within the annual return is necessarily brief. Boards and internal audit may, therefore, find the following more detailed guidance on each of the ten key areas of the report helpful:

<b>Subject</b>	<b>Guidance</b>
<b>A Proper book-keeping:</b>	The basic record of receipts and payments is always the starting point of any 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 designated Board member or member of staff may do the checking or verification; the internal auditor is trying to check that the verification within the system has been undertaken.
<b>B Financial Regulations:</b>  <b>a) Standing Orders</b> <b>b) Payment Controls</b>	The first step in establishing a financial system is to identify the general rules applicable at Board or committee meetings and in carrying out the Board's business. The Standing Orders, Financial Regulations and other internal instructions do this. Model versions of Standing Orders and Financial Regulations may be available from the national office of ADA. The internal auditor needs to have a copy of the current Standing Orders, Financial Regulations and any internal instructions. The internal auditor's annual report to the Board will include any recommendations for improvement in these documents arising as a result of his or her work during the year. The level of checking will depend on the content of the Standing Orders and

	<p>Financial Regulations.</p> <p>The amount of work may well vary, and more extensive testing of compliance may be needed from time to time, but as a minimum the internal auditor will test:</p> <p>(a) Purchase order procedures:</p> <ul style="list-style-type: none"> <li>• that the correct number of estimates, quotes or full tenders depending on estimated value of contract have been obtained (Standing Orders will state the value at which tenders are required; Financial Regulations or Standing Orders will show the value where estimates or quotes are required);</li> <li>• that proper purchase authority by Board, a committee or officers (under clear delegated powers) is in place; and</li> <li>• that a proper legal power has been identified for the expenditure.</li> </ul> <p>(b) Purchase payments:</p> <ul style="list-style-type: none"> <li>• that the supporting paperwork confirms that there is a fully approved invoice and authorisation for payment; and</li> <li>• that VAT is identified appropriately for reclaim.</li> </ul> <p>In most Boards 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 Board. The aim is for the internal auditor to check that the systems put in place by management are working and are appropriate.</p> <p>Internal audit should also check separately that payment of interest and principal in respect of loans (and in respect of investments if any are held) is in accordance with an agreed schedule.</p>
<p><b>C Risk management</b></p>	<p>The greatest risk facing an IDB is not being able to deliver the activity or services expected of the Board.</p> <p>The Board 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</p>

	<p>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 Boards on a cyclical basis.</p> <p>Minutes should be checked by the internal auditor 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 2.63 below.</p>
<p><b>D Budgetary controls</b></p>	<p>It is not the role of Internal audit to check or comment on the appropriateness of the budget. But it will seek to verify that a budget has been properly prepared and adopted in setting the rates and special levies. The regular reporting of expenditure, and variances from budget, is an important part of the proper control of public money. The internal auditor will expect to see the regular reports to Board and the variance analysis. That variance analysis and the decisions of Board or committee taken as a result may suggest areas for additional analysis by the internal auditor. Part of budgetary control is to ensure adequate but not excessive reserves or balances. Progress against budgets should be regularly monitored. It is particularly helpful when determining the likely rates that will be required for the following year. Internal audit will be keen to establish that this has taken place.</p> <p>More guidance on the budgetary process can be found in part 3, paragraph 3.29 onwards.</p>
<p><b>E Income controls</b></p>	<p>The internal auditor will look for evidence that the rates and any grant income is properly and promptly received. In value this is usually the largest item of income. The internal auditor 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 receipt issues, segregation of duties of the cashier and the invoice-raising clerk. The need for greater control implies a need for the internal</p>

	<p>auditor to verify the operation of all checks and balances. If the Board has let property or holds investments, then the Board should have established a system to ensure regular income collection; a diary of expected dates of income etc. The internal auditor 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>
<b>F Petty cash procedure</b>	<p>The internal auditor will be looking to see that there is an established system in place rather than ad hoc reimbursement. If officers and members are reimbursed for all small cost expenses or there is a separate cash float, a regular payment must be made to keep up to date. The internal auditor would be looking to see that reimbursement is regular and that on occasions an independent person physically counts the cash balance and checked to be in agreement with the up-to-date record. The Board should have a system for the regular approval of petty cash expenditure.</p>
<b>G Payroll controls</b>	<p>The internal auditor will be seeking reassurance that the system is delivering the correct payments for wages and salaries and that PAYE/NIC is correctly deducted from the gross pay and paid to HM Revenue &amp; Customs. One of the key areas of risk for Internal Drainage Boards is 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 the Board or can be regarded as a contractor. The clerk is always regarded as an employee. If a deduction for tax or national insurance is not made by the employer the government 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 Boards will need to be able to produce evidence that the correct tax treatment of salary has been arranged with the HM Revenue &amp; Customs (formerly known as Inland Revenue). The HM Revenue &amp; Customs seeks to avoid setting up a PAYE scheme for a single employee whenever possible, so will seek to “code out” any parish Board salary through other income, pension scheme or by direct assessment. The Board needs to have a letter from the Revenue confirming that arrangements to their satisfaction have been made for the particular employee. The internal auditor will be required to 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 Board, committee or less frequently the RFO. The Board should record evidence of such agreement. The internal auditor 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>
<p><b>H Asset management and control</b></p>	<p>The asset management and control responsibilities falling on IDBs cover the Board’s largest key business risk. To meet this responsibility for the stewardship of specialist assets, the Board is required to maintain an accurate and up to date register recording all critical information regarding each asset. The internal auditor will therefore be most interested in seeing that there is evidence that the continuing existence of these assets is checked on a regular basis and that the information in the register is accurate and up to date. In a larger Board 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 sufficient for the asset to be replaced should it be damaged or lost.</p>



	<p>If financial investments are held then the asset register will be a more active record; it should include details of cost, values, and expected income that will 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.</p>
<p><b>I Bank reconciliation</b></p>	<p>In most Boards, the bulk of the financial records will be concerned with a current account and a form of deposit account at a bank or building society.</p> <p>A regular feature of the financial system will be the reconciliation of the balances shown on the statements with those calculated in the Board'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. The internal auditor will wish to see that this has been done, but should not undertake the reconciliation each month. 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. That does not provide any form of control. The cash book record is written up from the cheque counterfoils and the paying-in books, together with the known direct payments and credits. It is the cash book record that is checked regularly against the bank statements to provide control.</p> <p>The bank reconciliation should include a note of the current level of investments held by the Board, if any, so that this can also be monitored to ensure that these funds are performing in the way planned by the Board and also so that the Board can have, each time this is reviewed, as complete a picture as possible of its liquidity and available funds.</p>
<p><b>J Year - end procedures</b></p>	<p>It is the duty of the Board and the RFO to produce the year-end financial statements. The internal auditor will be looking to see that the appropriate accounting basis is used, that the figures can be followed through on working papers and that adjustments, transfers, contras etc are fully explained or justified. Internal audit would not be expected to check all figures but would probably verify a small sample and the totals. In producing year-end financial statements there is a</p>

	<p>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 identified transactions in the one year that may relate to another.</p>
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- 2.60 It is not possible to draw up a standard internal audit programme for Boards in view of the need for each programme to assist the needs of each Board. What should be clear from the above expansion of the guidance given on the annual return is that the internal auditor is trying to observe and report whether the system of financial control put in place by management is adequate and working satisfactorily. It is not for the external auditor, nor the internal auditor, to be actively seeking evidence of fraud, corruption, error or mistakes. Their roles are to assist the Board in fulfilling its responsibility for the prevention and detection of fraud, error or mistakes.
- 2.61 Internal audit reports to the Board and its work is to a certain extent capable of constraint and direction by the Board. The external auditor reports to the Board and is only assisted by guidance and instructions issued by the Audit Commission, which appoints them, and the legislation under which they work.
- 2.62 It is proper for the internal auditor to carry out other tests on the systems of the Board. Such tests may be suggested by the external auditor or by the Board's own risk management process. All such work is to be reported to Board. Any report by the internal auditor is addressed to the Board, may suggest actions by the Board, and should be treated as a document open to view by external interested parties such as local government electors. A possible approach to testing by internal auditors is contained in Appendix 8 to this guidance. This is not a checklist requiring completion, but a suggested method of approach should the relevant areas be identified in any year for testing by internal audit.

## **Risk management**

- 2.63 In all types of undertaking, there is the potential for events and consequences that may either be opportunities for benefit or threats to success. Internal Drainage Boards are no different and risk management is increasingly recognised as being central to their

strategic management. It is a process whereby Internal Drainage Boards 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.

- 2.64 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 rate and council tax bills.
- 2.65 The external audit approach seeks to encourage Internal Drainage Boards 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.
- 2.66 It is unlikely that Boards will need to start risk management from scratch, as many features will already be in place. But there may be a need to adapt, improve and document existing processes.
- 2.67 The importance of looking afresh at risk comes in the wake of a more demanding society, bold initiatives and more challenge when things go wrong. It also arises because of the significant changes taking place as a result of the Government's modernising agenda. Internal Drainage Boards 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.
- 2.68 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 Board;
  - evaluate the potential consequences to the Board if an event identified as a risk takes place; and
  - decide upon appropriate measures to avoid, reduce or control the risk or its consequences.
- 2.69 It is impossible, and potentially dangerous, to attempt to present a suggested list of the risks which Internal Drainage Boards face, and this guidance does not do this. The complexity and scale of the business of Boards vary. Similarly the priorities and service delivery objectives of one Board will differ from those of others. For this

reason each Board must identify, for itself, the key risks to achieving successfully its priorities and service objectives. Identifying risks can be a daunting task and so Internal Drainage Boards 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.

- 2.70 Support for Boards wishing to improve their risk management arrangements, over and above that provided by this guidance, may be available through consulting the national office of ADA, and/or the Board's insurance provider.
- 2.71 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 Board should also evaluate the potential consequences of a risk occurring and consider how likely this is. The consequences may include immediate financial loss but even if the immediate impact is non-financial (such as an adverse impact on the Board's reputation) this can have financial consequences in the longer term if, for example, this impedes the Board's ability to bid for funds in future.
- 2.72 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 assessments enable the Board to decide which risks it should pay most attention to when considering what measures to take to manage the risks.
- 2.73 After identifying and evaluating risks Boards 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 Boards can face are given in the three tables at the end of this section of the guidance. The Board's internal auditor will have a role in reviewing the effectiveness of control measures that the Board decides to put in place. Examples of internal audit tests to confirm how effective are the measures and controls designed by the Board in respect of identified risks are also set out in the three tables at the end of this section.
- 2.74 The tables are, for ease of reference, grouped into the three main types of decisions that Boards 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].

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

**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 Board – specialist assets including watercourses and pumping stations, other buildings, machinery, equipment, furniture, etc (loss or damage)
- ✓ The risk of damage to third party property or individuals as a consequence of the Board providing services (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)
- ✓ Legal liability as an employer (employers' liability)
- ✓ Legal liability as the owner of motor vehicles (motor insurance)

**Internal controls**

A Board's internal controls may include:

- ✓ Asset management planning and process
- ✓ 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 Internal Drainage Boards means that Boards wishing to provide services often buy them in from specialist external bodies, e.g.

- ✓ Security for watercourses and pumping stations, vulnerable buildings, amenities or equipment
- ✓ Maintenance for watercourses and pumping stations, vulnerable buildings, amenities or equipment
- ✓ The provision of services being carried out under agency/partnership agreements with the Environment Agency or local authorities
- ✓ Banking arrangements, including borrowing or lending
- ✓ Vehicle or equipment lease or hire
- ✓ Professional services (engineering, planning, architects, accountancy, design, etc)

**Internal controls**

A Board'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
- ✓ Setting and 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 Internal Drainage Boards
- ✓ Complying with restrictions on borrowing
- ✓ Ensuring that all requirements are met under employment law and HM Revenue & Customs regulations
- ✓ Ensuring all requirements are met under Customs and Excise regulations (especially VAT)
- ✓ Ensuring the adequacy of the annual rates within sound budgeting arrangements
- ✓ Monitoring of performance against agreed standards under partnership agreements
- ✓ Proper, timely and accurate reporting of Board business in the minutes
- ✓ Responding to those 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 Board'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 the HM Revenue & Customs; contracts of employment for all staff annually reviewed by the Board, systems of updating records for any changes in relevant legislation
- ✓ Regular returns of VAT; training the responsible finance officer in matters of VAT and other taxation issues as necessary

### **Internal controls (continued)**

- ✓ 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 in statutory reporting
- ✓ Testing of specific internal controls and reporting findings to management



## Part 3

### Accounting guidance for Internal Drainage Boards

This part provides guidance on how Internal Drainage Boards can meet their statutory responsibilities most effectively, particularly in relation to the preparation of the statement of accounts (in the form of Section 1 of the Audit Commission annual return). It is structured as follows:

- Introduction;
- Routine financial procedures;
- Procedures for prompt and accurate recording of transactions and the prevention and detection of inaccuracies and fraud
- The budgeting process;
- The cash book;
- Asset management
- Preparing the Audit Commission annual return
- Audit notices and the presentation of the annual return
- Preparing the Defra annual report

#### Introduction

- 3.1 The Accounts and Audit Regulations 2003 as amended, provide a comprehensive framework for the accounts of an Internal Drainage Board. Taking the wider definition of what constitutes 'the accounts' this refers to:
- the day-to-day records of financial activity that help with the management of the Board's funds – the books of account; and
  - the summary of the Board's financial activity which is prepared at the end of each year for reporting to the public – the statement of accounts (i.e. section 1 of the Audit Commission's annual return).
- 3.2 The books of account, or an effective computerised accounting system, provide the basis for the statement of accounts, in that the statement of accounts is compiled from the information recorded in the books. But the books of account are important in themselves in the running of the Board throughout the year. A good set of books will allow a Board to appreciate at any time:
- the amounts that it has spent in the year, the income it has received and its financial commitments;

- whether, in the light of this information, its spending plans for the rest of the year are still affordable;
- the assets that it owns (things that will be of economic benefit to the Board in the future: e.g., specialist assets for watercourses and pumping stations, other buildings, machinery, vehicles, investments, cash) and the liabilities that it owes (e.g., outstanding payments for goods and services, borrowings); and
- the extent to which its funds are secured from loss by internal checks and controls.

3.3 These objectives are sensible in themselves, but to ensure that all Boards achieve a minimum standard of accounting, the Accounts and Audit Regulations 2003 as amended, specify certain things that Boards must do. References in this section to the 'responsible finance officer' mean that person who is responsible for the administration of the financial affairs of the Board or, if no person is so responsible, the person who is responsible for keeping the Board's accounts. Internal Drainage Boards must ensure that:

- the accounting systems, and the form of accounts and supporting accounting records, are determined by the responsible financial officer in accordance with proper practices and in a way that best assists the Board in managing its business;
- the responsible financial officer ensures that the accounting systems are operated properly and that the accounts and supporting records of the body are maintained in accordance with proper practices and kept up to date;
- the accounting records are sufficient to show the body's transactions and to enable the responsible financial officer to ensure that the statement of accounts complies with the Accounts and Audit Regulations 2003 as amended;
- the accounting records in particular contain:
  - entries, from day to day, of all sums of money received and spent by the body appropriately classified by category of income or expenditure;
  - a record of the assets and liabilities of the body;
  - a record of income and expenditure of the body in relation to claims made for contributions to funding, any grant or subsidy from the Government; and
- the accounting control systems include:
  - measures to ensure that the financial transactions of the body are recorded as soon as reasonably practicable and as accurately as reasonably possible, measures to enable the prevention and detection of inaccuracies and fraud, and the ability to reconstitute any lost records;

- identification of the duties of officers dealing with financial transactions and divisions of responsibilities of those officers in relation to significant transactions;
- procedures for uncollectible amounts, including bad debts, not to be written off except with the approval of members, or under delegated authority, the responsible financial officer, and for the approval to be shown in the accounting records.

### **Routine Financial Procedures**

- 3.4 This section of the guidance summarises the requirements of the Accounts and Audit Regulations 2003 as amended, for the accounting framework that should be maintained by Internal Drainage Boards.
- 3.5 The Board must formally determine in whom the responsibility of responsible financial officer is vests. It is recommended practice that the roles of chief operating officer and chief financial officer are always separated.
- 3.6 The appointment of a responsible financial officer does not mean that members then have no responsibility for the financial health of the Board. Members continue to be accountable for ensuring that the Board does not live beyond its means, but the responsible financial officer takes on the duty of designing and implementing the accounting arrangements that will assure members that finances are being properly managed and be able to provide them with timely and accurate management information.
- 3.7 The following table summarises the duties that are placed on the responsible financial officer and suggests the arrangements that might be put in place to ensure that these duties are met:

<b>Statutory duty</b>	<b>Possible arrangements</b>
1. The responsible financial officer determines the body's accounting systems and the form of their accounts and supporting accounting records.	<ul style="list-style-type: none"> <li>• the Board should make it a formal duty of the responsible officer to keep accounting systems under continual review to ensure their adequacy for the Board's purposes</li> <li>• the Board must facilitate this duty by ensuring that the officer is competent to meet their responsibilities (either by requiring certain qualifications on appointment or by training) and providing sufficient resources for the running of the systems</li> </ul>

<b>Statutory duty</b>	<b>Possible arrangements</b>
<p>1. The responsible financial officer determines the body's accounting systems and the form of their accounts and supporting accounting records (continued)</p>	<ul style="list-style-type: none"> <li>• the accounting systems that are used will be particular to each individual Board. The smallest may require nothing more than an account book and a file in which to store bills. Larger Boards might need an integrated computer package, with facilities for payroll, debtors, creditors and VAT.</li> </ul>
<p>2. The responsible financial officer ensures that the accounting systems are observed and that the accounts and supporting records of the body are maintained in accordance with proper practices and kept up to date.</p>	<ul style="list-style-type: none"> <li>• measures for ensuring accounting systems are observed include making available a written record of procedures, training staff to operate the systems properly and regular internal audits to confirm effective operation;</li> <li>• certain procedures are designed to confirm that accounting systems have been observed, the most notable being the preparation of the bank reconciliation (see below). Good practice would be to report to each Board meeting that the latest bank reconciliation has been prepared successfully;</li> <li>• the proper practices specified by the Accounts and Audit Regulations 2003 as amended are represented by the contents of this guidance; and</li> <li>• the requirement to be up-to-date means that transactions should be entered in the records as soon as possible after they take place. Backlogs should not be allowed to develop, and, where other officers are responsible for spending money and collecting income, then procedures will need to be in place to inform the responsible financial officer of their dealings for entry in the accounts. Timeliness is made easier if the Board has arrangements for the latest financial position to be reported at each Board meeting.</li> </ul>

<b>Statutory duty</b>	<b>Possible arrangements</b>
<p>3. The accounting records are sufficient to show the body's transactions and to enable the responsible financial officer to ensure that the statement of accounts complies with the Accounts and Audit Regulations 2003 as amended</p>	<ul style="list-style-type: none"> <li>• the responsible financial officer must ensure that the accounting systems are sufficiently detailed to record each individual transaction that is entered into.</li> <li>• accounting records will be sufficient to ensure that the statement of accounts complies with the Accounts and Audit Regulations 2003 as amended, if they allow the analysis of transactions in accordance with Section 1 of the Audit Commission annual return (see below).</li> </ul>
<p>4. The accounting records in particular contain:</p> <ul style="list-style-type: none"> <li>- Entries from day to day of all sums received and expended by the body and the matters to which the income and expenditure or receipts and payments account relate;</li> <li>- A register of fixed and other key assets and liabilities of the body;</li> </ul>	<ul style="list-style-type: none"> <li>• day to day records (Example 1)</li> <li>• asset register (Example 2)</li> </ul>
<p>5. The accounting control systems include:</p> <ul style="list-style-type: none"> <li>- Measures to ensure that the financial transactions of the body are recorded as soon as reasonably practicable and as accurately as reasonably possible, measures to enable the prevention and detection of inaccuracies and fraud, and the ability to reconstitute any lost records</li> </ul>	<ul style="list-style-type: none"> <li>• document and adopt control systems to clarify everyone's duties and responsibilities and to encourage a culture that does not tolerate bending or breaking the rules</li> <li>• review systems at least annually or more frequently if required following any significant change of procedure or key personnel</li> <li>• add new systems if there is a business need to do so</li> <li>• report annually to the Board prior to their completion of the annual return</li> </ul>

Statutory duty	Possible arrangements
<ul style="list-style-type: none"> <li>- Identification of the duties of officers dealing with financial transactions and divisions of responsibilities of those officers in relation to significant transactions</li>   <li>- Procedures for uncollectible amounts, including bad debts, not to be written off except with the approval of the Board and for the approval to be shown in the accounting records.</li> </ul>	

**Procedures for prompt and accurate recording of transactions and the prevention and detection of inaccuracies and fraud**

3.8 The guidance in the following paragraphs should be taken into consideration by Boards when determining their procedures for prompt and accurate recording of transactions and the prevention and detection of inaccuracies and fraud.

*Accounts for payment*

3.9 Boards should make Standing Orders that include provisions for securing competition and regulating the manner in which tenders are invited. Boards should set a limit for the purchase of goods and services above which three estimates or quotes should be invited from persons or firms competent to do the work. A second, higher level should also be set above which competitive tenders in sealed envelopes should be invited. It is the responsibility of Boards to determine their own limits that are most appropriate to local circumstances.

3.10 As far as possible, a fully priced official order should be sent to suppliers in advance of delivery of goods. Official orders both commit a supplier to a price and help prevent unauthorised credit being granted in the Board's name.

3.11 On receipt of invoices, verification that the relevant goods or services have been received should be obtained and invoices checked to ensure that the arithmetic is correct, agreed discounts have been deducted and everything is acceptable regarding reclaiming the VAT.

- 3.12 Procedures for the management of capital projects should also be covered by Standing Orders and conform with proper practices, in particular regarding payments against certified completions under a planned and approved programme of works governed by a properly negotiated contract.
- 3.13 The payment process should always be carried out in accordance with legal requirements, the Board's own Financial Regulations and scheme of delegation. Once the invoices have been approved, cheques or any other order for payment must be signed in accordance with Standing Orders/Financial Regulations. In addition to the members signing, the clerk or responsible financial officer may also be required to sign cheques or other similar bank instructions.
- 3.14 Similar arrangements and controls must be put in place if the board authorises the use of modern banking methods including BACS, telephone or internet banking or other innovations. Boards should assure themselves that their responsibilities and internal controls are not being in any way diluted by such arrangements and that coverage by internal audit following instigation is thorough.
- 3.15 Cheques for payment should only be released once confirmation has been obtained that adequate funds are available. Payments should be reported to the next Board meeting. Members should never sign blank cheques, funds transfers or similar bank instructions which are presented unsupported by the appropriate documentation.
- 3.16 The Board should develop control procedures for any payments by bank transfer, or other electronic means, taking into account the risks brought about by the ease and speed of these transactions and the difficulties faced in unravelling them should they go wrong.
- 3.17 If there is any doubt as to how much the Board owes to one of its regular suppliers, the supplier should be asked to send a statement of the Board's account. It is appropriate to request statements as at 31 March each year to assist with the preparation of the annual return.

#### *Receipts*

- 3.18 Cash and cheques should be entered into the cash book on the date of receipt and banked promptly and intact (i.e., without any of the cash being kept back for spending).
- 3.19 Where any person, such as an employee or member carrying out the usual activities of the Board, receives money on behalf of the Board,

it should be made clear that it is their responsibility to ensure that such funds are either banked or promptly deposited with the responsible financial officer. Anyone handling cash on behalf of the Board should be properly trained in the procedure that they are to operate and be provided with the appropriate duplicate receipting and recording documents. With such an arrangement, the responsible person in receipt of the money would need to maintain a record showing, in strict date order, the money and cheques received and bankings or deposits made. This collection and deposit record needs to be examined from time to time to ensure that bankings are made regularly and that the cumulative totals match to the cash book and banks' statements.

#### *Cash balances*

- 3.20 Where a Board builds up a balance of receipts, these need to be safeguarded by investing the amount in an appropriate account. Investment of balances by Internal Drainage Boards is governed by the Trustees Investment Acts.
- 3.21 Before finalising and adopting procedures and internal control systems involving cash, the responsible financial officer should always check the requirements of insurers under Fidelity Guarantee insurance cover arrangements, which may well specify the amount, location and minimum security arrangements required regarding the handling of cash or bank balances.
- 3.22 The number of petty cash floats should be kept to a minimum and should not be used when an official order is more appropriate. The floats should be adequate in size to meet small items of expenditure and should not require reimbursement more frequently than once a month – this will require careful setting of float levels. Adequate records of the receipts and payments should be maintained for each float and regular reconciliation performed, usually with such regularity that successful reconciliation can be reported at each Board meeting

#### *Debts due to the Board*

- 3.23 Effective debt collection is an essential part of proper financial management. Internal Drainage Boards need to ensure that invoices raised are paid promptly or that appropriate recovery action has been taken. Additionally, debts shown to be unrecoverable should be written off, after full consideration by the Board of the possibilities for and the likely costs of pursuing the debt.
- 3.24 Debt monitoring arrangements should be in place covering all activities of the Board which involve receiving payment. For example



a separate record of all rate and levy payers would be appropriate for that purpose. The record would need to include details of the person who owes the debt, the amount, the arrears brought forward at the start of the accounting period, amounts due in the year, amounts paid in the year, any debts written off, and a note of the current state of any recovery action taken.

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

#### *Payroll*

- 3.26 The remuneration payable to all staff must be approved in advance by the Board. Guidance on this issue is issued from time to time by the Association of Drainage Authorities and should be referred to.
- 3.27 Internal Drainage Boards with any employees are, by definition, employers and are, therefore, required to operate under Pay As You Earn (PAYE) rules from HM Revenue and Customs. PAYE and National Insurance should be deducted in every instance unless authority to the contrary has been received from HM Revenue & Customs in writing. Such deductions should be passed on to the Collector of Taxes on or before the date prescribed.
- 3.28 Internal Drainage Boards should pay particular attention to situations where contractors are engaged to carry out the Board's services, including the role of clerk. The rules are somewhat complicated and occasions may arise when contractors cease to be self-employed and become employees for tax purposes. As part of risk management, advice should always be sought from HM Revenue and Customs to ensure that payments for services are being correctly treated; otherwise Boards may find themselves with unexpected and significant liabilities to pay income tax and employers National Insurance contributions. Existing arrangements should be periodically confirmed with HM Revenue and Customs to ensure that they continue to be compliant with tax rules.

#### *Insurance*

- 3.29 All employers are required to take out employers' liability and fidelity guarantee insurance and all cover should be kept under constant review.
- 3.30 Adequate insurance against third party risks is vital especially for owned property, vehicles and machinery and should also be kept

under constant review making sure it adequately reflects disposals and new acquisitions.

- 3.31 The Board should review the range and value of insurance cover each year. At the expiry of each policy, consideration should be given to inviting competitive quotations for the new policy.

### The budgeting process

- 3.32 The preparation of an annual budget is one of the key tasks to be taken by a local Board, irrespective of its size. The budget has three main purposes:

- it results in the Board setting the rates and the special levy for the year;
- it gives the clerk and other officers authority to spend money, in accordance with the plans approved by members; and
- it provides a basis for monitoring progress during the year by comparing actual spending against planned spending.

- 3.33 The importance of the budget should not be underestimated, and it is essential that Board members understand how it is put together and how it should be used in the running of the Board. At its simplest the budget compares what a Board would like to spend in the forthcoming year with the amount of income it expects to generate, with the excess of planned spending over income being made up by the rates. But as the year progresses, things will not always go to plan – reviewing the budget against actual expenditure will give warning when this happens and help in deciding what action to take.

- 3.34 The following table sets out the process for preparing and making use of the annual budget:

1	Deciding the form of the budget	The first decision that a Board must take is the level of detail at which to prepare the budget. This involves scheduling out all the headings under which the Board expects to make payments or is likely to receive income. An estimate will then be prepared for each of these headings of the expected value of transactions that will take place in the next year.
2	Review the current year budget and spending	In making estimates, most Boards will start by looking at current year figures, with three main purposes: <ul style="list-style-type: none"> <li>• to identify activities that are being carried out</li> </ul>

	<p>this year that will also be carried out next year and need to be budgeted for again (e.g. statutory inspections, permanent staff costs, planned maintenance)</p> <ul style="list-style-type: none"> <li>• to identify things that are happening in the current year that will not happen next year and do not need to be budgeted for again (e.g. a one-off refurbishment of offices, running costs of a pumping station that is to be decommissioned)</li> <li>• to identify items that are not in the current year budget, and need to be added for next year's budget (e.g., major drainage works for a new property development, cost of additional staff)</li> </ul> <p>This process is called "incremental budgeting", as it builds on the decisions that the Board has taken in the past.</p> <p>An alternative approach that Boards sometimes take is to start with a clean piece of paper and build a fresh budget that is not constrained by what has happened in previous years. This is sometimes described as "zero-based" budgeting and is a helpful exercise for the board to carry out from time to time to identify possible efficiency savings.</p>
<p>3 Determine the cost of spending plans</p>	<p>Having determined what the Board wants to spend its money on, the next stage is to work out the costs of its plans. For existing activities, this will require an assessment of likely changes in the level of the activity and the possible impact of wage and price inflation. The prices of new activities will have to be estimated using the best information currently available including external sources.</p>
<p>4 Assess levels of income</p>	<p>Careful consideration should be given to budgeted levels of income for the forthcoming year. Many Boards may have no other income but the rates, but for others the budget setting process will usually be the time when decisions are taken about what level fees and charges should be set for the next twelve months.</p>

<p>5 Bring together spending and income plans</p>	<p>For many activities, spending and income decisions will be linked directly – e.g. servicing a new property development in the area may require additional personnel and travel costs but will also generate more income from charges.</p> <p>However, it is an important stage of the budget process when spending plans are brought together with assessments of income to see how affordable the plans are. When doing this it is usual practice to be more optimistic about spending plans (i.e. to expect that the Board will be able to carry out all its plans and spend as intended) and more pessimistic about income levels (i.e. to assume that the Board might not be able to generate all the income it hopes to).</p> <p>Affordability will usually be judged by the impact the overall plans will have on the level of rates and levies. If there is an increase in the Board's budgeted net spending for next year over the current year, would this result in an increase in the rates that would be acceptable to the local ratepayers as an addition to their Council tax? In fact, many Boards will work the other way around: deciding first what a reasonable increase would be for the rates and then working out what the extra funds generated can be spent on.</p>
<p>6 Provide for contingencies and consider the need for balances</p>	<p>Some Boards may have absolute certainty in their spending plans for the forthcoming year in providing only those services required by statute. However, most Boards will have some uncertainty in their plans, perhaps because of general factors such as weather patterns, inflation or changes in interest rates on cash deposits or specific things such as not knowing exactly how much firms will tender for the refurbishment work planned for pumping station equipment.</p> <p>Before committing itself to its spending plans, the Board should review the need for amounts to cover contingencies, in case of inaccurate weather predictions, inflation is higher than</p>

	<p>expected or works are more costly than was first thought. The amounts added to the budget should not be excessive. Boards might work to the principle that it is better to raise cash from higher rates and not use it than to set the rates too low, and so run out of cash and run the risk of incurring an unlawful overdraft.</p> <p>A well-managed Board will also look forward beyond the end of the year for which the budget is being set and think about whether there are any substantial, usually capital, future commitments that it would be prudent to set aside funds for over time to limit borrowing risk.</p> <p>Most Boards will therefore budget to carry forward a balance, to cover contingencies and specific spending plans. This means that in setting the budget the Board will have to estimate what balance will be brought into the new year, decide what balance it wants to carry forward and charge the difference against the new year's rates</p>
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<p>6 Provide for contingencies and consider the need for balances (continued)</p>	<p>It is possible that the Board's spending plans, particularly capital expenditure, may require a level of external borrowing. Borrowing by Internal Drainage Boards is subject to government controls and, with certain limited exceptions, the Secretary of State's approval is required. He or she may impose conditions in accordance with which the borrowing shall be carried out. Boards must always take advice before commencing any contractual borrowing arrangements. Defra have useful guidance available to assist Boards in making borrowing decisions and obtaining the necessary approvals and funds.</p> <p>Boards should also be aware of, and have internal controls in place for, avoiding the possibility of 'accidental' borrowing which can occur, for example when capital equipment is acquired under leasing arrangements or regular payments are made at a low point in the Board's cash flow cycle, i.e. at year-end,. Decisions to pay, buy, hire or lease should always be taken with the rules and guidance governing borrowing in mind.</p>
<p>7 Approve the budget</p>	<p>Having determined the planned levels of spending, anticipated income and the balances needed to be carried forward for contingencies and future spending plans, the budget needs to be approved. Much of the work preceding this stage may be delegated to the responsible financial officer, but the Board must approve the finalised budget. Sufficient information needs to be provided with the budget papers so that members can make a reasonable and informed decision about the desirability and affordability of the plans for the coming year.</p> <p>There is no statutory requirement to publish the budget, but many Boards follow good practice and elect to do so.</p>
<p>8 Confirm the rates</p>	<p>The important statutory stage of the budget process is confirming the rates that are to be raised and the amount of the special levy on the local authorities in the Drainage Area. The law</p>

	<p>requires that agricultural rate and special levy payers be notified within 10 days of the rate/levy being set.</p> <p>All other parts of the budget process should be timed so that the date for setting the rates can be achieved comfortably.</p>
<p>9 Review progress against the budget</p>	<p>Once the budget has been approved, it should be used as an active tool for managing the Board's finances. The well-run Board will have the following arrangements in place:</p> <ul style="list-style-type: none"> <li>• progress reports prepared periodically through the year, showing spending and income to date against budgeted amounts. Care should be taken to profile the budget across the year and not necessarily assume, say, that half the budget would have been spent after six months. An effective report would therefore show actual and planned expenditure to date as well as projections for the full year based on the spend to date and future plans;</li> <li>• the budget progress report is presented at each Board meeting. This would provide members either with comfort that the spending plans were proceeding as hoped or with information about areas where spending was higher or lower than anticipated. In the latter case, members will be able to consider the need to amend their expenditure plans, (perhaps by switching amounts from one budget heading to another that is overspent – known as ‘virement’), to take steps to increase income, or to make decisions about using the funds that have been saved for contingencies. It is good practice to change a budget that is shown by experience to be ineffective. However, changes should only be made with the authorisation of those who approved the original budget.</li> </ul>

3.35 Boards should only use receipts from the sale of fixed assets ('capital receipts') for specified purposes, of which the main ones are the repayment of external debt and the financing of capital

payments. Financial Regulations should set this restriction out clearly. Capital payments relate to the acquisition, construction and enhancement of land, buildings, vehicles, plant and equipment. This work generally involves high levels of payments that need to be properly planned over an appropriate timescale. Boards should have a long-term capital budget or a rolling capital replacement programme.

- 3.36 The capital budget should also be reviewed annually and the impact of any capital schemes on the revenue budget assessed. This is particularly important in relation to the running costs that will be incurred when a new asset is brought into use. Where such schemes cannot be funded from capital balances the impact on borrowing and the level of the rates will have to be considered.

### **The Cash Book**

- 3.37 The most important accounting record maintained by smaller Internal Drainage Boards will be the cash book – a register of all the payments made and receipts taken in by the Board. Larger Boards may operate a computerised accounting system where the equivalent to the cash book is in an electronic format. In either case, what is being referred to here is the ‘book of prime entry’ where all money based transactions occurring should be recorded. This is the Board’s key accounting record. For ease of reference this ‘book of prime entry’ will be referred to as the cash book throughout this guidance.
- 3.38 There may be a temptation to rely on the bank statement as a record of transactions. However, a cash book is essential because the statements provided by the bank may not necessarily be a reliable record of the Board's cash balances because:
- the bank can make errors and omissions in processing transactions - the Board needs its own records to provide a check on the bank statement;
  - there can be considerable timing differences between writing cheques to other parties and their being cashed by the bank and between receiving income and it being credited to the Board's account – the bank statement therefore takes time to catch up with the actual cash flows of the Board and cannot provide an up-to-date position.
- 3.39 The cash book therefore provides the day-to-day record of all cash and cheques received and cash payments made, cheques drawn and all other movements involving money, including inter-account



transfers. However, there is no prescribed format for the cash book. Depending upon the complexity of the Board's finances, it can be kept in a notebook, a ledger, or on a computer spreadsheet or specialist accounting package

- 3.40 Whatever medium is used for the cash book, it will normally be set out or viewable in a columnar format – the date and description of the transaction will be written in the left-hand column, and the value of the transaction entered in other columns across the page according to the nature of the receipt or payment. The headings for the columns will be chosen by the Board to cover the main categories into which their transactions fall.
- 3.41 Example 1 at the end of this part shows a typical layout for the cash book. Examples have been deliberately made simplistic for ease of understanding.
- 3.42 The basic principles for managing a cash book effectively are:
- the cash book should start each year at 1 April on a fresh page or new spreadsheet, with the first entry being the cash balance brought forward at the end of the preceding financial year; if a page is filled during the course of a year, the page should be balanced off and balances carried forward to the top of the new page (see below for guidance on balancing off);
  - all entries should be dated – receipts should be recorded on the day that the cash or cheque comes into the Board's possession (not when banked); payments should be recorded on the day that cash is handed over or cheques despatched (not when the cheques are eventually cashed). No cash book entries should be made for income that the Board knows it should have received but has not, or monies that it should have paid over but has not or cheques written but not despatched – these are items for inclusion in the listing of assets and liabilities at year end;
  - details of the transaction should be entered, as well as a reference to supporting documentation – the description should be sufficiently detailed to allow the cash book to be understandable if the supporting documentation were lost or destroyed, but not excessively so. Each Board will have its own referencing system for voucher numbers, linking to the bills, invoices, receipts, etc, that support the cash transaction, usually using the numbers already marked on the Board's own documents and marking up new serial numbers on the documents received from other parties;

- when recording receipts and payments, it is useful, particularly as an aid to bank reconciliation, to employ a system in which the gross receipts and payments are written down in their own columns on the left-hand side of the cash book and the receipts and payments are also then analysed on the right-hand side across the various account headings that the Board has chosen. The account headings in the cashbook analysis are usually the same ones that the Board has chosen for its budget.
- This system is helpful because:
  - it has an element of internal check in it, because, if all the entries have been made properly, the total of the left-hand side and the sum of all the columns on the right-hand side will equal each other;
  - it is particularly useful for separating out the reclaimable VAT elements of receipts and payments for the preparation of claims for reimbursement by HM Revenue and Customs; and
  - it also makes for easier budget monitoring as each of the columns can be ruled off and added periodically and then compared against the planned budget spend for the same period.
- where a Board has more than one bank account, it may be easier to operate a separate cash book for each account, treating transfers between accounts as receipts and payments in the same way as for transactions with other parties. However, if the Board only has a straightforward savings account, there may be room in the cash book for two additional columns for the receipts and payments of the savings account.

3.43 What this means in practical terms is that if, for instance, the clerk had ordered goods from a supplier on credit in the Board's name and spent £30 on computer supplies and £20 on cleaning materials, arranging for a cheque for £50 to be drawn to settle the bill, then the following would happen:

- the need to make the payment of £50 would be recorded on the Board's list of liabilities when the goods are received;
- just before the cheque is put in the post, entries in the cash book would be required;
- a gross payment of £50 would be written in the payments column on the left-hand side of the cash book;
- entries would be made in the appropriate columns on the right-hand side of the cash book for computer supplies and cleaning materials to the value of £25.75 and £16.80 respectively (i.e., net of 17.5 per cent VAT) and for reclaimable input VAT of £7.45.

- 3.44 Apart from making day-to-day receipts and payments entries on a timely basis, there are two important tasks that have to be performed on the cash book:
- reconciling the cash book to the bank statement; and
  - balancing the cash book at the end of the financial year.
- 3.45 Circumstances will arise when it is necessary to cancel a cheque or a payment after it has been drawn. If the cheque has been made out incorrectly, (wrong name, date, amount, etc.), it should not be destroyed but crossed through with the word 'cancelled' written across the face and stapled to the back of the cheque book or kept safely for future reference. An entry in the cashbook should be made recording the date, the cheque number and the fact that it has been cancelled. Missing cheques which are unexplained arouse unnecessary suspicions.
- 3.46 If the error is discovered after the cheque or payment has been recorded in the cashbook, it is not helpful simply to cross through the entry. Good practice would be to record the cancellation as an entry in the receipts column giving all the details of number, name, date and amount together with a comment that this represents a cancelled cheque. If the cheque has already been sent, a copy of the letter to the bank cancelling the payment should be kept in the file of cancelled cheques.
- 3.47 These cancelled cheque procedures, if followed, will allow the process of balancing the cash book (see below) to take place most easily.

#### *Reconciling the cash book to the bank statement*

- 3.48 Bank statements are important documents as they are evidence provided by an independent party of the state of the Board's cash balances. They contrast with the cash book, which is the Board's own record of its cash position. It is consequently an invaluable exercise to compare the balances on the bank statement and in the cash book at any particular date and to investigate the reasons for any differences between them. This comparison (the reconciliation) will reveal whether there are any errors or omissions in either the bank records or the cash book. Cheques drawn properly have been known to be altered by recipients before being banked.
- 3.49 Whenever it is done, the reconciliation should cover each of the Board's bank accounts. Normally Boards will operate a current account through which most transactions are made, and possibly

one or more deposit accounts. In addition the Board may have some of its funds held in approved investments. These should also be noted on the reconciliation to give the reader a complete picture of the Board's current financial position.

- 3.50 Bank reconciliation is a key tool for management as it identifies available funds at a specific moment in time which aids good decision making, particularly when there are competing priorities. The year-end bank reconciliation is particularly important as it will 'prove' the total cash and investments balance shown on the Board's annual return (Section 1 line 8). As bank statements may be made up to different dates in the month, care should be taken, particularly at year end, to ensure that the statement being reconciled includes balances as at 31 March.
- 3.51 Some Boards will carry out a reconciliation every time they receive a bank statement, which is good practice as it identifies bank errors early on. It is for each Board to decide how regularly it wants to receive the assurance that a successful reconciliation can provide. Reconciling the cash book to bank statements should be reported to members, and the full reconciliation made available for their scrutiny each time it is done. The latest reconciliation should be available for each meeting of the Board. Approval of the bank reconciliation by the Board or the chair of finance or another Board nominee is not only good practice but it is also a safeguard for the RFO and may fulfil one of the Boards internal control objectives.
- 3.52 There are a limited number of reasons for differences between bank statements and the cashbook, and most Boards will be able to use a standard layout for the bank reconciliation. The common reasons are:
- **unpresented cheques** – payments are recorded in the cash book when the authority commits itself to making them, usually by handing over a cheque, putting a cheque in the post or completing the instructions for an automated payment; the balance on the bank account will not reduce until several days later when the cheque or instruction is received by the bank and processed. Unpresented cheques therefore need to be deducted from the bank statement balance in the reconciliation;
  - 'payments into the bank' which are outstanding (sometimes referred to as '**cash in transit**') – receipts are recorded in the cash book when they come into the possession of the Board; however, they will not be recognised on the bank statement until after cash is banked or cheques are presented for clearance.

Payments in to the bank which are outstanding from the bank statement therefore need to be added to the bank statement balance in the reconciliation; and

- there may be **transactions in the bank statement that are not recorded in the cash book** – this will particularly apply to interest payable and bank charges, which might be advised to the Board for the first time through the bank statement. The bank statement may also show up direct debits, standing orders and other automated payments that have been omitted from the cash book. None of these is strictly an item for the reconciliation, however. Instead, the cash book should be updated to record all of these transactions, and the resulting balance is then brought into the reconciliation.

- 3.53 Where a Board has more than one bank account, each account should be balanced to the cash book, including any inactive accounts that may be open. In these circumstances there will be a third category of possible reconciling items – transfers between accounts that have been requested but not yet processed by the bank.
- 3.54 Practitioners should note that transfers are neither receipts nor payments so they should not be included in the totals of receipts and payments in the cashbook. In the cash book, inter-bank account transfers will always be in balance as an addition to one account generates an equal and opposite withdrawal in the source account.
- 3.55 The other main source of information for the bank reconciliation arises where non bank investments are held. The most common forms are building society deposits, treasury stock or stock market investments from the range permitted by the Trustee Investments Acts.
- 3.56 Pass books should be updated as at 31 March and any interest accrued recorded in the cash book. Any dividends received on other investments will be recorded as income in the normal way. Tax liability on investment income should always be assessed at the time of receipt and appropriate provision made. Investment income should always be recorded gross and any irrecoverable tax deduction as an expense within the same transaction. The investment position should be disclosed in the bank reconciliation.
- 3.57 A standard layout for a financial year-end bank reconciliation would look something like this (although the model can be applied for reconciliations carried out at any time of year):

### **Bank Reconciliation**

Board Name \_\_\_\_\_

Financial year ending 31 March 20xx

Prepared by \_\_\_\_\_ (Name and role [clerk/RFO etc]) Date \_\_\_\_\_  
Approved by: \_\_\_\_\_ (Name and Role RFO/Chair of finance, etc) Date \_\_\_\_\_

<b>Balance per bank statements as at 31 March 20xx:</b>		<b>£</b>	<b>£</b>
e.g.	Current account	1,000.00	
	High interest account	3,000.00	
	Building society premium a/c	10,000.00	
			14,000.00
<b>Less: any unrepresented cheques at 31 March (normally only current account)</b>			
	Cheque number 000154	(50.00)	
	000157	(18.00)	
	000158	(2.00)	
			(70.00)
<b>Add: any unbanked cash at 31 March</b>			
e.g.	Rates payments banked 31 March (but not credited until 1 April)	50.00	50.00
Net bank balances as at 31 March			13,980.00
Add: Value of investments* - 200 units of XYZ @ 2015p			4,030.00
<b>Total Cash and Investments 31 March 20xx</b>			<b>£18,010.00</b>

*The net balances reconcile to the Cash Book (receipts and payments account) for the year, as follows:*

### **CASH BOOK**

Opening Balance	15,280.00
Add: Receipts in the year	6,500.00
Less: Payments in the year	(7,800.00)
Closing balance per cash book [receipts and payments book] as at 31 March 20xx (must equal net bank balances above)	13,980.00
Add: Value of investments as at 31 March 20xx*	4,030.00
<b>Total Cash and Investments 31 March 20xx</b>	<b>£18,010.00</b>

*\*Note: If the Board holds investments they should be added, at cost, to the closing balances of the Cash Book and included in Box 8 of the annual return (see also paragraph 3.66 below)*

3.58 The procedure for preparing the bank reconciliation will usually be to:

- enter the balances from each of the bank statements for the chosen date at the head of the page;
- review the bank statements for transactions that have not been recorded in the cash book, such as interest and bank charges, and make the appropriate cash book entries;
- balance off the cash book (see below) and enter the resultant balance at the foot of the page;
- identify the cheques that have been recorded as drawn in the cash book but have yet to show up on the balance sheet – this will usually be the cheques that have been drawn on the days immediately prior to the bank statement date, but there may be

others where the payee is taking a long time to present the cheque at its bank;

- identify the cash collected or cheques received that have not been banked in sufficient time for the bank to have processed them and add them to the bank balance;
- if (bank balance – unpresented cheques + payments in to the bank outstanding) does not then equal the cash book balance, an in-depth analysis of the bank statement and cash book may be necessary to discover the reason for the unreconciled difference; and
- the bank reconciliation should always be balanced to the penny – you cannot stop looking for reconciling items once the difference has been reduced to a tolerable amount, as this difference might actually be made up of two significant undiscovered errors (one positive and one negative) that by chance cancel each other out.

### *Balancing the cash book*

3.59 The process of "balancing the cash book" involves putting new entries in the cash book so that the totals in the receipts and payments columns equal each other. However, this equalisation is done paradoxically in order to confirm the differences between the two.

3.60 The purpose of balancing the cashbook is to establish a closing balance position. How to do this is explained as follows (and demonstrated in Example1 at the end of this part of the guidance):

- the first step in balancing the cash book is to add up the figures in the receipts and payments columns, including the brought forward cash figure – in the example this gives totals of £2,119.12 and £784.99 respectively;
- as a cross check, the totals in the receipts and payments columns on the left-hand side should be reconciled to the detailed receipts and payments entries on the right-hand side. This requires that the brought forward cash balance is ignored in the totals for the left-hand side (i.e., in the example, the total for receipts would be reduced from £2,119.12 to £1,110.37, the receipts actually taken in the year) and that the right-hand totals add back in the VAT elements that have been separated out;

- looking at the totals for the receipts and payments columns on the left-hand side, the next step is to work out the amount that would bring whichever is the lower of the two figures (£784.99) up to the value of the higher (£2,119.12). In this example, the difference is a net receipt of £1,334.13. This figure is entered under the lower of the two figures as "balance to be carried forward". This figure will become the "balance brought forward" which opens the next financial period. Practitioners should always check that the opening balance in the cashbook is identical to the 'balance to be carried forward' from the previous period;
- when the balance carried forward is added to the total figure (in this case under the payments column) it should equal the total for the other column (£2,119.12). The cash book is thereby balanced, and is ruled off to start a fresh period of accounting. The figures that balance are not very meaningful in themselves – it is just important that they are the same; and
- to complete the process, the balance carried forward at the end of the old period is entered as the first item in the new period of accounting. This is done by entering the balancing figure (£1,334.13) in the other column to the one that was used in the balancing process. This figure will then represent the cash balance carried forward to the new period, either cash-in-hand (if in the Receipts column) or cash overdrawn (if in the Payments column). It is the figure that is used as the cash book balance in the bank reconciliation.

### **Accounting for Fixed Assets**

- 3.61 This section covers the arrangements for acquiring, maintaining and eventually replacing those items of a capital nature, whose value is high and have a useful life of more than a year. These items are usually described as Fixed Assets comprising the sum of all specialist watercourses and pumping stations assets, other buildings, plant, machinery, vehicles, etc.
- 3.62 These fixed assets are critical in supporting the delivery of flood risk management and land drainage services, and represent the single highest value risk area for the Board. If these assets are not being managed properly, the Board is exposed to the risk of financial loss relating to:
- Asset management – decisions about asset usage which were right at the time that they were taken may be invalidated by changing circumstances, including technological advances and



environmental pressures. Without the right management information, outdated patterns of usage may run on unchallenged or unnoticed;

- Asset usage – assets may not be fit for purpose, be underused or be so out of date as to be incapable of satisfactory modernisation. Equally they may be capable of alternative, additional or more intensive use or be readily saleable. These opportunities may be missed where no comprehensive information on assets is available; and
- Asset ownership – the ownership of assets may be overlooked altogether. As a result, the cost of using an asset in a particular way is ignored and so no return on can be generated on the capital which is tied up. In addition, the assets are exposed to an increased risk of deterioration, misappropriation, misuse or loss.

3.63 These risks are most likely to be realised when information is poor. In particular where information about assets is not available or access to information about assets is denied by being out of date or non-existent. The risk of financial loss can be greatly reduced by setting up and maintaining an **asset register** which holds all the information needed.

3.64 An asset register is the starting point for any system of financial control over assets as it:

- facilitates the effective physical control of assets;
- provides the information that enables the Board to make the most cost effective use of its capital investment resources;
- ensures that no asset is overlooked or under-utilised and is therefore used most efficiently;
- pools all the information available about each asset from across the organisation and makes it available to every part of the organisation, and
- supports the annual return entry for capital assets by collecting the information on the cost or value of assets held (and be used to determine accounting charges to the various activities using the asset).

3.65 The key information needed in the asset register is:

- dates of acquisition, upgrade and disposal (it is useful to keep a record of disposed assets as an asset management tool);
- costs of acquisition and any expenditure which increases the life of the asset;
- useful life estimate;
- location;

- responsibility (it is good practice to assign responsibility for each asset to a manager);
- present use and capacity, for example in terms of site area, internal floor areas, and measures of occupancy and/or usage:
- corresponding periodic measures of usage or occupation;
- any available indications of asset value and condition, and
- charges for usage or occupancy.

3.66 Investments and debtors are other forms of assets which are likely to be owned by the Board. These too may be vulnerable to risks of loss or mismanagement and so the asset register approach described above should also be applied to each of these asset categories. Up to date information on each category is required at the year end to be able to complete the annual return and accompanying information.

### **Preparing the Audit Commission annual return (see Appendix 6)**

3.67 Section 1 of the Audit Commission's annual return for Internal Drainage Boards represents the statutory statement of accounts that Boards are required to prepare each year, to have audited and to publish. If the books of account have been kept in good order during the year and the cash book has been balanced and reconciled to the bank statement at the 31 March, and the asset registers are up to date, then the Return should be straightforward to prepare.

*For Boards with gross income or expenditure (whichever is the higher) in any year of £200,000 or less*

3.68 For Boards with gross income or expenditure (whichever is the higher) in any year of £200,000 or less, the Return may be prepared on a "receipts and payments" basis, or, if the Board so wishes, it may be prepared on an "income and expenditure basis. An "income and expenditure" basis is where the accounts would add in all the amounts that the Board owes at the year-end (e.g., an unpaid electricity bill) as spending for the year, and anticipate amounts owed to the Board (e.g., unpaid river bank rents). But the "receipts and payments" basis requires Boards only to consider their actual cash transactions. If the receipts and payments method is used, the entries for the annual return will usually be taken straight from the summary totals in the cash book.

3.69 For example, if the Board whose cash book is shown in Example 1 had no further transactions for the year, then its annual return would be compiled like this:

		This Year £	Last Year £	Notes on compilation from the <i>Example 1 cash book</i>
1	Balances brought forward	1,009		<i>This should be the brought forward figure shown at the head of the cash book for this year – it will equal the last year figure in line 7 of the Return</i>
2	(+) Rates and special levies	600		<i>The total in the Rates and Special Levies columns on the income side of the cash book</i>
3	(+) All other income	510		<i>The total in the Receipts column (£2,119.12), less the balance brought forward (£1,008.75) and the annual rates (£600).</i>
4	(-) Watercourses and pumping stations	(200)		<i>Total of operatives wages from the cash book</i>
5	(-) Loan interest/capital repayments	NIL		<i>No interest received or capital payments made</i>
6	(-) All other expenditure	(585)		<i>The total in the Payments column (£785) less staff costs (£200) in box 5</i>
7	(=) Balances carried forward	1,334		<i>The sum of the above entries</i>
8	Total cash and investment	1,334		<i>As line 7 – no other balances held but cash</i>
9	Total fixed assets and long term assets	NIL		-
10	Total borrowings	NIL		-

## Example 1 Cash Book Layout

Date	Details	Voucher No	Receipt	Payment	Receipts			Payments			VAT Transactions			
					Planning Fees etc	Rates	From EA	Water courses	Administration	To EA	Property maint'ce	VAT on expenses	VAT on income	VAT claim Repayment
	balance brought forward		1,008.75											
20XX														
1 April	Operatives wages	1		100.00				100.00						
2 April	Cleaning materials	2		24.65								20.98	3.67	
8 April	Planning assistance fee	3	75.00		75.00									
21 April	Gas bill	4		102.34								102.34		
22 April	Repair of broken window	5		45.00									6.70	
27 April	Planning assistance fee	6	100.00		100.00									
30 April	From Rates account	7	600.00			600.00								
1 May	Operatives wages	8		100.00				100.00						
7 May	Planning advice	9	75.00		75.00									
15 May	VAT reimbursement	10	10.37											10.37
17 May	Kitchen supplies	11		29.29								24.93	4.36	
17 May	EA contribution	12		250.00						250.00				
19 May	Electricity bill	13		96.02								81.72	14.30	
24 May	Planning assistance	14	150.00		150.00									
27 May	Office supplies	15		37.69					32.08				5.61	
31 May	EA grant	17	100.00				100.00							
	sub-totals for the period		1,110.37	784.99	400.00	600.00	100.00	200.00	32.08	250.00	268.27	34.64	-	10.37
	totals		2,119.12	784.99										
31 May	balance carried forward		2,119.12	1,334.13										
1 June	balance brought forward		1,334.13											

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

*For Boards with gross income or expenditure (whichever is the higher) in any year between £200,001 and £1,000,000*

- 3.70 For Boards with gross income or expenditure (whichever is the higher) in any year between £200,001 and £1,000,000 the return has to be prepared on an "income and expenditure" basis. In income and expenditure accounts, the transactions for the year comprise all those instances in the twelve months where the Board has received economic benefits (irrespective of the year when it will pay for them) or given others economic benefits (irrespective of the year when it will receive payment for them). Accounting on an income and expenditure basis ensures that creditors and debtors are accounted for properly, which is more important for larger organisations incurring more significant levels of expenditure.
- 3.71 For example, suppose a Board engages contractors to carry out major repairs which are completed in March but the firm does not manage to issue an invoice until April, and the Board does not settle the bill until May. The cash book will therefore record cash outgoing in May of the new financial year. However, the Board will have received the benefit of the works before the end of the financial year in March and have an obligation to pay the builders, even though their invoice has not arrived to confirm the exact amount due. In order to show the proper financial position of the Board for the old year, expenditure should be recognised in March.
- 3.72 In contrast, a developer pays a retainer in February for site drainage advice needed in the following June. The cash book would record a cash receipt in February. However, the Board will not be providing any economic benefits to the developer (in the form of advice) until June of the new financial year. The receipt would not then count as income in the old financial year and would be a prepayment to be accounted for in the new financial year, when an invoice for the service would be issued.
- 3.73 Income and expenditure accounting thus gives a more sophisticated presentation of a Board's true financial position, focusing on the balance of economic benefits that it has under its control, rather than just its cash balance.
- 3.74 Most Boards will already maintain their books of account on an income and expenditure basis. The cash book will be the main focus for day-to-day accounting and balancing off and reconciliation to the bank statement will remain the most important controls over the accounting system. Subsidiary records will be kept of the Board's debtors (people who owe the Board) and creditors (people the Board

owes) based on invoices, but transactions will be made in the cash book for this activity only when cheques and cash are actually received.

3.75 This means that there will need to be a special exercise at the end of each financial year to convert the receipts and payments record represented by the cash book into the income and expenditure account required by Section 1 of the annual return.

3.76 The exercise can be complex because care has to be taken to make adjustments for both ends of the financial year. For example, as well as adding in amounts owed at the end of the year that are not in the cash book, payments that are in the cash book but relate to amounts owed at the end of the previous year have to be taken out. The process is usually carried out using an accounting tool called the 'extended trial balance' – see example at paragraph 3.79 below.

3.77 The types of adjustments required to the cash book balances comprise:

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

not yet received the relevant goods or services by 31 March	<ul style="list-style-type: none"> <li>• <i>add</i> the amount of prepayments excluded from the calculation of expenditure for the previous year</li> <li>• <i>deduct</i> the amount of prepayments made at the end of this year</li> </ul>
<b>Stock:</b> consumable goods (e.g., maintenance supplies) purchased before the end of the year but which have not been used by 31 March	<p>To adjust for stock in expenditure take the cash book totals for maintenance goods and:</p> <ul style="list-style-type: none"> <li>• <i>add</i> the amount of stock brought forward as an asset from the previous year</li> <li>• <i>deduct</i> the amount of stock held at the end of this year</li> </ul>
<b>Provisions:</b> any other situation in which the Board has an obligation to make a payment, but it is uncertain when the payment will be due (e.g., a claim has been made for compensation against the Board that is likely to result in the Board eventually making recompense) (NB, this is only likely to occur in rare circumstances for Boards.)	<p>To adjust for provisions in expenditure take the cash book totals for payments and:</p> <ul style="list-style-type: none"> <li>• <i>add</i> the value of any provision that needs to be made for events taking place in this year</li> <li>• <i>deduct</i> the value of any provisions made in previous financial years and brought forward, to this financial year and where payment has been made to settle the obligation and those no longer required.</li> </ul>

3.78 Boards will need to have effective arrangements in place to identify and calculate the adjustments needed. These will include:

- deciding on a level of materiality for adjustments – income and expenditure needs to be shown fairly, but excessive accuracy is not beneficial. For instance, most Boards will have office utilities bills that include prepayments for standing charges and payments in arrears for energy consumption that should be adjusted for into their appropriate years. However, as these are regular items of expenditure and not significant in value it is not usually worth apportioning individual bills across financial years, but just ensuring that four bills (if payable quarterly) are charged in full to each year.
- making sure that a record is retained of the adjustments that were made in preparing the income and expenditure accounts for the previous financial year (the ‘extended trial balance’);

- examining entries in the cash book before 31 March for possible receipts in advance and prepayments and entries after 31 March for possible debtors and creditors;
- examining invoices after 31 March for possible debtors and creditors;
- assessing the value of stock at the 31 March (having a formal stocktaking if the Board has a proper stock control system); and
- considering whether the Board has any other obligations arising from events that took place before 31 March that mean it will not be able to avoid making a payment at some time after 31 March.

*Notes applicable to all Internal Drainage Boards*

3.79 Compilation of the Return from the cash book might not always be straightforward. The following table discusses the difficulties that might arise with each line of the Return:

1 Balances brought forward	The balance brought forward at the start of the current year should match the balance carried forward at the end of the previous year. However, it is always possible that errors and omissions can be found in the accounts, even after an audit. If it is found that there were mistakes in the previous year's accounts, then the current year Return should be prepared as if the mistake had not been made – i.e. the last year figures for the balance brought forward should be the corrected figures and not those published last year. A note should be prepared for the auditor explaining the mistake and how it has been corrected this year. A note on the statement of accounts should draw readers' attention to the adjustment made.
2 (+) Rates and Special Levies	This figure is the total of rates and special levies received in the year, regardless of which year they actually relate to (i.e. may include unpaid rates from previous years or rates paid in advance for next year)
3 (+) All other income	This figure will simply be the total cash receipts taken by the Board in the year, reduced by the value of rates and levies recorded in the preceding box (2). If the statement of accounts is being prepared on a receipts and payments basis, VAT charged on goods and services provided by the Board should be



	<p>included, even though the tax is payable to HMRC.</p> <p>Some adjustments may be necessary where the Board has more than one bank account – transfers between bank accounts (e.g. between current and deposit account), would show up as receipts and payments for the individual accounts in the cash book, but they are not receipts and payments for the Board as a whole. Both sides of a transfer between the Board's own bank accounts should be ignored when adding up receipts and payments for the year as they should sum to zero.</p>
4 (-) Watercourses and pumping stations	<p>This figure comprises all costs related to the building of and maintaining watercourses in the drainage area, including gross payments made in relation to the employment of direct labour staff. All capital expenditure should be recorded here. Where the Board has to make deductions for PAYE and National Insurance and pay employer's contributions for NI and pensions, then the amount should include payments to HM Revenue &amp; Customs, etc.</p>
5 (-) Loan interest/capital repayments	<p>Most active Boards will make borrowings and will have interest and capital repayment transactions to record in the accounts. For those that have borrowed from the Public Works Loans Board, the figure will be the payments made in the year in accordance with the PWLB repayment schedule (which includes interest and capital). If a Board goes overdrawn at the bank, then any interest or charges paid as a result of the overdraft should be included under this heading. However, bank charges other than those arising as a result of temporary borrowing should not be included in box 5 but added to other payments in box 6.</p>
6 (-) All other expenditure	<p>This figure should simply be the total cash payments made by the Board in the year, reduced by the value of watercourse construction and maintenance and loan interest and capital repayments recorded in the preceding two boxes. If the statement of accounts is being prepared on a receipts and payments basis, VAT on goods and services acquired by the Board should be included, even though the tax is reimbursable by HMRC. Some adjustments may be necessary where the Board has more than one bank account and transfers have been made between them – see Total other receipts above.</p>

7 (=) Balances carried forward	This should be the total of all the preceding entries, taking care to get the + and – entries the right way round. It should also match the balance carried forward on the cash book at the end of the year.
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3.80 Having prepared a receipts and payments account from the cash book, the receipts and payments account needs to be converted into an income and expenditure account by the adjustments set out below. Suppose that the Board in Example 1 had the following circumstances:

Debtors	<ul style="list-style-type: none"> <li>• the planning assistance fee of £75 received on 8 April 20xx was paid in arrears for an invoice dated 30 March 20xx before the year start and had been accounted for as a debtor in last year's income figure</li> <li>• a further fee of £200 for work carried out on 14 March 20yy was not paid until 30 April 20yy after the year-end</li> </ul>
Receipts in advance	<ul style="list-style-type: none"> <li>• Developer assistance fees of £300 were taken before 1 April 20xx for work scheduled to take place after 1 April and this was accounted for as receipts in advance in last year's income and expenditure figure</li> <li>• the fees of £150 received on 24 May 20xx were for work that did not take place until April 20yy in the following financial year</li> </ul>
Creditors	<ul style="list-style-type: none"> <li>• the payment of £45 for the repair of a window made on 22 April was for work carried out before the start of the year and had been accounted for as a creditor in last year's income and expenditure figures</li> <li>• no payment has yet been made for the replacement of a door in February 20yy – an invoice received after the year-end confirms that £56 is payable</li> </ul>
Prepayments	<ul style="list-style-type: none"> <li>• before 1 April 20xx the Board paid £220 in advance for a service cover agreement on its computer equipment for the year starting on 1 April 20xx</li> <li>• the EA contribution £250 paid on 17 May was to cover the period running from June 20xx to May 20yy, extending beyond the end of the financial year – one sixth of the grant (around £40) is a prepayment for amounts due after 31 March 20yy</li> </ul>

Stock	<ul style="list-style-type: none"> <li>checks of the levels of disposable protective clothing stocks showed that £120 was held at 31 March 20xx and £70 at 31 March 20yy</li> </ul>
Provisions	<ul style="list-style-type: none"> <li>in July 20xx there was an accident at the pumping station that resulted in slight injury – the Board's solicitor estimates that the Board will end up with a bill for compensation of £300 that will not be covered by insurance</li> <li>in November 20xx, an earlier claim for accident compensation was settled without the Board having to pay a penny – however, a provision had been made in the previous year's income and expenditure account for £100 for a likely settlement</li> </ul>

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

		R + P £	Previous year adjustments £	Current year adjustments £	I + E £	Notes on compilation from the receipts and payments account
1	Balances brought forward	1,009	(30)	-	979	<i>This should equal the last year figure in line 7 of the Return and the adjustment requires replacing the R+P amount with last year's I+E figure</i>
2	(+) Annual rates	600	0	0	600	
3	(+) Total other receipts	510	(75) 300	200 (150)	785	<i>Debtors adjustments Receipts in advance adjustments</i>
4	(-) Staff costs	(200)	0	0	(200)	
5	(-) Loan interest/capital repayments	0	0	0	-	
6	(-) Total other payments	(585)	45 (220) (120) 100	(56) 40 70 (300)	(1,026)	<i>Creditors adjustments Prepayments adjustments Stock adjustments Provisions adjustments (note – as the payments figure is presented as a negative, deductions from payments are shown as positive figures and additions as negatives.)</i>
7	(=) Balances carried forward	1,334	0	(196)	1,138	<i>The sum of the above entries</i>

3.82 As a check that the income and expenditure figures have been properly prepared, Boards should balance the balance carried forward in line 7 back to the assets and liabilities held at 31 March that have been taken into account in the conversion. Using the figures above:

	£
Balance carried forward	1,138
Cash (positive if credit, negative if overdrawn)	1,334
Debtors (positive figure)	200
Receipts in advance (negative figure)	(150)
Creditors (negative figure)	(56)
Prepayments (positive figure)	40
Stock (positive figure)	70
Provisions (negative figure)	(300)
	1,138

3.83 The other boxes in Section 1 of the annual return will be compiled separately from the income and expenditure exercise:

8	Total cash and investments	<p>For most Boards, this line will be identical to the figure carried forward from the end of year balanced cash book that was taken into account in the bank reconciliation.</p> <p>Boards should review their schedule of assets and liabilities to see if there are any balances of investments that are not reflected in the cash book balance. For instance, the Board might have invested surplus funds in Government securities, and the purchase of these would have been accounted for as if it were a payment out of the cash book, suggesting that the Board had spent money rather than invested it. In order to give a fair view of the Board's finances, the value of these investments (as recorded in the schedule of assets and liabilities) should be added to this line.</p>
9	Total fixed assets and long term assets	<p>This should be the value of all fixed assets owned by the board as recorded in the asset register or schedule of assets and liabilities, measured at current book value. See paragraphs 3.60 to 3.65 above for a fuller discussion of asset registers. "Current book value" should be an informed assessment of the open market value of the asset or the cost of reconstructing it in its existing condition – either way, the value ascribed by professional insurance assessors as the basis of replacement insurance premia presents an</p>

	<p>excellent approximation which may be used by the Board to value its assets.</p> <p>If the Board has made non fixed asset investments such as the purchase of shares or other financial instruments then an investments register should also be kept. The total at box 9 for any year should equal the value at 31 March shown in the asset register and the investment register. Any valuation adjustments should be made in the relevant registers.</p>
10 Total borrowings	<p>This should be the value recorded in the schedule of assets and liabilities for all types of borrowing. If Boards have borrowings, they will usually comprise short-term overdrafts at the bank or longer-term loans from the Public Works Loan Board or other lenders. The amount borrowed at 31 March should be easily calculated by reference to bank statements or loan repayment schedules.</p>

- 3.84 The annual return procedure requires that the auditor is provided with supporting documentation for the accounts in Section 1. Because of its importance as confirmation that the Board's books of accounts are supported by the bank's records, the most important document to be provided is the year-end bank reconciliation. Bank reconciliation should be prepared to at least the detail of the example in paragraph 3.56 above. The auditor will be able to appreciate the reason for any difference between the year-end cash book and bank account balances and the nature of the items that reconcile the difference. A separate reconciliation will be expected for each of the bank accounts operated by the Board although these can be summarised on one sheet for convenience.
- 3.85 The other supporting documentation required to accompany the annual return is a brief explanation of significant year-on-year variations between the figures on the annual return. This is because the auditor will be considering the reasonableness of the return using a technique called analytical review. The auditor will look at the Board's figures for last year and, using his or her knowledge of the Board and of the influences over the Board this year, develop an expectation for what this year's figures should be. These expectations will be compared with the actual figures and, where they are significantly different, the auditor will have some concern that the accounts might be wrong. Boards are able to remove this doubt by providing explanations where the differences between this year and last year are not straightforward.

- 3.86 For example, the expectation is that without a change in the scale of the Board's activities, staffing costs rise each year by around the figure for average wage inflation. Thus, if the clerk's remuneration had risen from £400 to £416 year on year, this could reasonably be assumed to be attributable to a cost of living increase. However, if the remuneration had risen to £600, then the auditor would need reassurance that a mistake had not been made in recording staff costs. If the explanation was that the Board had implemented tighter new financial procedures that required the clerk to work 50% more hours a week, this should be set out in the note to the auditor.
- 3.87 The important thing about such notes is that they serve to remove doubts about possible errors or omissions, and they therefore need to explain fully the difference. For example, a note stating simply that staff costs had risen 50% because the clerk's hours had risen 50% would still leave the question as to why the hours had risen this year.
- 3.88 It is impossible to give definitive guidance on what "significant" year-on-year variations are by, for example, giving a standard percentage figure below which movements do not need to be explained. It might sometimes be significant that there has been no change between this year's and last year's figure. For instance, if a Board's other payments were high in one year because of exceptional expenditure on refurbishing a pumping station, then the auditor would expect in the following year that payments would fall back to the usual level rather than remain at the same high value as the previous year. "No change" in the accounts would in this case be significant and need explanation.
- 3.89 The test for significance is then usually whether, if the figures were amended to leave an item out, someone reading the annual return would get a different idea about how much the Board had spent or how much income it had generated in the year, enough to think it had done better or worse than it actually had.
- 3.90 In deciding what needs commenting on, Boards should consider the following:
- one-off items of spending or income from last year and this year;
  - regular items of spending and income where the relevant activity (e.g. number of developer projects) has risen or fallen between the two years or where prices have not changed in line with inflation (e.g. a negotiated price freeze on materials);

- items of spending and income that used to be regular but which were made for the last time last year and do not feature in the current year (e.g. a loan paid off or a lease determined); and
- items of spending and income that were made for the first time in the current year and will be made regularly in future years (e.g., maintenance expenses for a newly constructed waterway).

### **Audit Notices and the presentation of the annual return**

- 3.91 The Audit Commission Act 1998 and the Accounts and Audit Regulations 2003 as amended, contain important provisions that open the accounts of a Board up to public scrutiny. As Boards are custodians of public funds, interested members of the public, as well as local agricultural rate and special levy payers, have rights to satisfy themselves about the regularity of a Board's finances and to ask questions and make objections to particular items of account. These opportunities for scrutiny cover both the books of account and the statement of accounts, but are restricted to particular times. Although Boards are not required to open their books on request, increasingly there is a move towards their doing so in pursuit of demonstrating openness and transparency.
- 3.92 The particular things that the Board must do to facilitate public rights in relation to the accounts are:
- advertise the rights of the public at the appropriate times;
  - allow public inspection of the annual return and the supporting books of accounts for Section 1 and other documents once the return has been approved; and
  - display the annual return after it has been audited, together with the auditor's report, and make available other audit documents.
- 3.93 The Board's appointed external auditor is the person responsible for setting the date of the commencement of the audit period from which time electors may exercise their rights. This date will usually be agreed with the responsible financial officer before the auditor's notice of audit is sent to the Board. Once received, this notice should be advertised by publication or by display in a prominent place. Similarly, the auditor's certificate, which effectively closes the audit for any particular year, must be displayed when it has been received. The auditor's certificate of completion may be found in section 3 of the annual return.
- 3.94 The Board has to carry out its duties in accordance with the law. As with all aspects of the law, there is scope for interpretation as to what the provisions of the Accounts and Audit Regulations 2003 as

amended require. A common issue arising is whether Boards have any discretion to restrict access to the books of accounts if they suspect that the interested party is seeking to get hold of personal or commercially sensitive information.

- 3.95 Boards are therefore recommended to read the requirements of the Accounts and Audit Regulations 2003 as amended, and use this guidance only to provide support for the conclusions they arrive at themselves as to what the Regulations require them to do. Where there is doubt, Boards should consider taking legal advice.
- 3.96 The external auditor is not responsible directly for enforcing the provisions relating to public scrutiny. However, as the audit might not be properly carried out if the responsibilities to others have not been met (e.g., failure to advertise the audit), auditors may be willing to comment on issues that the Board is having difficulty resolving.
- 3.97 The following timetable summarises the tasks that a typical Board will need to schedule in order to prepare the accounts and facilitate the audit process (references are to the Accounts and Audit Regulations 2003 as amended):

Step	Task	Comments
1	Arrange for the Board to receive the documents needed to prepare the annual return	Likely tasks include: <ul style="list-style-type: none"> <li>• requesting bank statements for 31 March for all bank accounts</li> <li>• arranging for savings account books to be made up to date for 31 March</li> <li>• obtaining written confirmation of other investments at 31 March, including interest for the year</li> </ul>
2	Close, balance and reconcile the cash book and update the schedule of assets and liabilities	This should be done as soon as practicably possible after the end of the financial year, and certainly in good time for the Board to approve Section 1 of the annual return by June 30 (see step 5). For advice on balancing and reconciling the cash book, see paragraphs 3.37 to 3.60 For advice on preparing income and expenditure adjustments, see paragraphs 3.70 to 3.78.
3	Receive confirmation of the date of audit with the auditor	As part of their statutory responsibilities, the external auditor will appoint a date when local electors may exercise their right to ask questions about the accounts. They may



		<p>issue a formal objection to any item of account, requesting the auditor to declare an item unlawful issue a report in the public interest. The Board has no official role to play on this date, but needs to know the date as steps 4 and 6 have to be scheduled to be completed before it.</p> <p>There is no statutory requirement to do so, but auditors should also provide Boards with a date by which it is expected that the annual return will be completed and audit work can start.</p>
4	Display a notice of public rights under audit	<p>In preparation for step 6, Boards are required by Regulation 16 to advertise or display in a conspicuous place in the Board's area a notice (or notices) setting out:</p> <ul style="list-style-type: none"> <li>• the period during which the accounts and other documents will be available for inspection</li> <li>• the place at which, and the hours during which, the accounts and documents will be available</li> <li>• the name and address of the auditor</li> <li>• a summary of the rights conferred on the public by sections 14 and 15 of the Audit Commission Act 1998 (public inspection of accounts and the right to challenge the accounts),</li> <li>• the auditor's appointed date for the commencement of the audit</li> </ul> <p>The notice is required to be displayed for at least 14 days (counting non-working days) immediately before the date in step 6. As step 6 has to be started at least 20 working days before the auditor's appointed date, this means that the notice must be given at least six weeks before the appointed date (and longer if there are any public holidays during the inspection period). It is important that the Board ensures that the notice is posted promptly and that it remains displayed for the whole 14-day period.</p>

5	Submit the statement of accounts to the Board for approval	<p>Regulation 10(2) requires the responsible financial officer to sign and date the statement of accounts, income and expenditure account and statement of balances, or record of receipts and payments, as the case may be. The RFO must also certify that it presents fairly the financial position of the Board at the end of the year to which it relates and its income and expenditure or that it properly presents receipts and payments, as the case may be, for that year. The certification is already set out in Section 1 of the annual return and just needs the signature of the responsible financial officer (subject to their confirming that the statements therein are correct).</p> <p>After certification, Regulation 10(4) requires that the accounts be approved by a meeting of the Board (or one of its committees if the Board's Standing Orders permit delegation of this duty) and that the person presiding at that meeting must sign and date the accounts to signify the completion of the approval process. Again, there is space on Section 1 of the annual return to record the Board's resolution and the presiding member's signature. It is sensible to do this before the accounts are made available for inspection in step 6, but this is not a statutory requirement. However, Regulation 10(4) (a) also requires that it is done as soon as reasonably practical and by 30 June at the latest (transitional arrangements are in place from 2006 for which the approval date is September 30. This date will come forward by one month each subsequent year until 2009).</p>
6	Make the statement of accounts and other documents available for inspection	Regulation 14 requires the accounts and all books, deeds, contracts, bills, vouchers and receipts relating to them to be available for inspection by interested parties for 20 working days before the auditor's appointed date for audit. The Board can require that interested parties give reasonable notice that they wish to inspect records and do not

		<p>have to grant immediate access on request. The public are entitled to make copies of any of the documents available for inspection.</p> <p>This can be the most contentious part of the accounts and audit process, where allegations can arise that documents are not being made available or that interested parties are taking wrongful advantage of the inspection period. Section 15 (4) of the Audit Commission Act 1998 prevents a Board from releasing certain personal information about members of staff. In other cases where a Board wishes to withhold information, legal advice should be sought.</p>
7	The audit	<p>Section 6 of the Audit Commission Act 1998 entitles the auditor to access at all reasonable times to all documents of the Board that the auditor determines are necessary for the audit. The auditor also has a right to require any persons holding or accountable for documents to provide any information and explanations the auditor thinks necessary for the audit. This right covers third parties who may be holding documents relevant to the transactions of the Board.</p> <p>In most instances, however, the audit will be carried out co-operatively, with the Board and the auditor agreeing a time when the audit work is to be performed and the responsible financial officer will be available to assist the auditor.</p> <p>The Audit Commission provides guidance to external auditors on how their audit work should be carried out. Summarised guidance from the Audit Commission to its appointed auditors may be viewed at Appendix 5 below.</p>
8	Display the statement of accounts	<p>Regulation 12(3) states that as soon as reasonably possible after the completion of the audit (or by 30 September at the latest) the local Board should display a copy of its statement of accounts and the auditor's</p>

	<p>certificate in a conspicuous place for at least 14 days. This requirement is met by displaying of Sections 1-3 of the annual return. Copies should also be kept for purchase by any person who may be asked to pay of a reasonable sum.</p> <p>If the accounts are displayed before the audit certificate is received, the notice should declare this and explain the fact that an audit opinion has not yet been given.</p> <p>DCLG (formerly ODPM)'s guidance circular on the Accounts and Audit Regulations 2003 as amended (04/2003) clarifies what is meant by "publication" in Regulation 12 and gives examples of good practice (see Appendix 7). Although publication does not require any preparation beyond the annual return nor the distribution of copies of the statement of accounts to persons who have not expressed an interest in receiving them, it does require positive action.</p> <p>Publication does not mean merely the appearance of the accounts in the documents of meetings, committees or sub-committees of the Board. Nor is the requirement covered by merely providing copies to enquirers on demand. Good practice might include putting a copy on each of the Board's notice Boards, copying it onto a website, publishing it as a separate leaflet or publication in a newspaper or as part of a newsletter.</p> <p>It is a matter for the Board to consider the appropriateness of the publication arrangements they have in place, bearing in mind the need to make information as widely available as practicable, but also taking into account local circumstances, including the size of the local Board, the resources available, the number of electors, and the existence of any local information networks</p>
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9	At the conclusion of the audit, display a notice of public rights	<p>Regulation 16(2) requires that as soon as possible after the auditor has certified that the audit is completed the Board should for at least 14 days display a notice in a conspicuous place that the statement of accounts (Section 1 of the annual return) is available for inspection.</p> <p>The statement of accounts that is made available (not the notice itself) must:</p> <ul style="list-style-type: none"> <li>• contain any amendments required by the auditor's report (or a statement of the amendments that were required)</li> <li>• if auditor's amendments have been made, be accompanied by an explanation as to the material respects in which the accounts have been altered</li> <li>• contain a statement of the rights of local electors under section 14 of the Audit Commission Act 1998 to inspect and copy the statement of accounts and auditor's reports</li> <li>• state the address at which and the hours during which the statement of accounts and auditor's reports are available for the exercise of these rights.</li> </ul>
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**Example 2**  
**Schedule of Assets – Fixed Assets**

Ref No	Description	Identification/ serial number	Date Acquired	Original cost (if known)	Current insurance valuation	Location/ Custodian	Disposal/Discharge
001							
002							
003							
004							
005							
006							
007							
008							
009							

Notes:

1. This layout for a schedule of assets would only be suitable for a small Board that does not have many fixed assets, or hold stocks. Other Boards would need to separate the schedule into different documents:
  - a detailed register supporting a planned maintenance record for waterways and pumping stations including plant, machinery and capital tools
  - an inventory of other property
  - an inventory of financial Investments
  - stock control records (e.g. for maintenance supplies)
  - debtors ledgers (e.g. for agricultural ratepayers)
  - a register of loans including repayment and interest records
  
2. In determining the layout needed, the objectives to keep in mind are that the schedule should help the Board:
  - to know at any time what its assets and liabilities are and keep them under control; and
  - to prepare the entries in the annual return

## Part 4

### Guidance for Larger Internal Drainage Boards

This part contains proper practices accounting guidance for Internal Drainage Boards with Income or Expenditure exceeding £1million ('Larger IDBs'). It explains and provides an example of how they can meet their statutory responsibilities most effectively, particularly in relation to the preparation of the statement of accounts. It is structured as follows:

- **Background to the adapted FRSSE**
- **Section 1 – General requirements and accounting principles**
- **Section 2 – The Statement of Accounts in detail**
- **Section 3 – An outline statement of accounts for XYZ IDB**

#### Background to the adapted FRSSE

- 4.1 This accounting guidance is designed to assist Internal Drainage Boards (IDBs) to prepare statements of accounts with due regard to “proper practices”, that is, the relevant professional standards, which given the scale of IDB’s activities, are applicable to them.
- 4.2 IDBs, governed by the Land Drainage Act 1991 and with a turnover in excess of £1 million per annum are “relevant bodies” as defined by the Accounts and Audit Regulations 2003 (as amended). The regulations require<sup>2</sup> such bodies ‘to prepare, in accordance with proper practices in relation to accounts, a statement of accounts each year...’ Guidance issued by the Department for Communities and Local Government (CLG) in support of the regulations<sup>3</sup> confirms that there is no statutory definition of proper practices for IDBs and that as such it is for IDBs to identify the appropriate professional guidance containing proper practices.
- 4.3 In the absence of a statutory definition of proper practices it is appropriate to look to the pronouncements of the Accounting Standards Board. Larger IDBs may choose to adopt ‘United Kingdom Generally Accepted Accounting Practices for smaller entities’, following the provisions of the Accounting Standards Board’s Financial Reporting Standard for Smaller Entities issued in January 2007 (FRSSE 2007)<sup>4</sup>.

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<sup>2</sup> Regulation 7 of the Accounts and Audit Regulations 2003 (as amended)

<sup>3</sup> CLG Circular 03/2006

<sup>4</sup> Available from [www.frc.org.uk/documents/pagemanager/asb/FRSSE-Jan2007%20web%20optimized.pdf](http://www.frc.org.uk/documents/pagemanager/asb/FRSSE-Jan2007%20web%20optimized.pdf)

- 4.4 The ADA recommends that larger IDBs follow the provisions of the FRSSE 2007 as presented herein. The guidance in this Part should be applied to all accounting periods commencing on or after 1 April 2008 and may be adopted by Boards to apply to earlier accounting periods. Other IDBs, operating below the turnover threshold, will continue to complete an annual return and are not required to prepare and submit accounts on this basis.
- 4.5 By adopting and applying the FRSSE, larger IDBs become exempt from applying more complex accounting standards such as Statements of Standard Accounting Practice, other Financial Reporting Standards and Urgent Issues Task Force Abstracts.
- 4.6 This guidance is designed to advise IDBs on the application of the FRSSE to their financial statements taking into account their statutory functions but in doing so IDBs should note that the provisions of the FRSSE 2007, subsequent amendments or its successor take precedence.
- 4.7 Section 1 below covers general principles and accounting concepts for the accounts. Section 2 describes the statements of accounts in greater detail and the form of their presentation.

## **Section 1 General requirements and accounting principles**

### **The structure of the accounts**

- 4.8 IDBs that exceed the turnover threshold should follow the FRSSE when preparing their financial statements recognising that not all of the elements do apply to the IDBs given their statutory framework, powers, duties and functions. The statements of account subject to audit should consist of the following:
- an annual report<sup>5</sup>
  - an annual governance statement
  - a statement of responsibilities for the statement of accounts
  - a statement of accounting policies
  - an income and expenditure account
  - a statement of movement of reserves
  - a statement of total recognised gains and losses<sup>6</sup>
  - a balance sheet
  - notes to the accounts
  - the auditor's report.

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<sup>5</sup> The annual report is not covered by the auditor's certificate. However, financial information contained in the annual report must be consistent with the financial statements and notes.

<sup>6</sup> Only required if gains and losses (for example from the revaluation of assets) are not recognised in the I&E account.



The Accounts and Audit Regulations 2003 require a statement of internal control, prepared in accordance with proper practices, to be included with the financial statements. This requirement is met by including the annual governance statement with the financial statements. Departmental guidance<sup>7</sup> identifies this document as the source of appropriate professional guidance on proper practice in relation to internal control, details of which may be found in Part 2 above.

- 4.9 An IDB should add such additional information or statements as are necessary to ensure a true and fair view of its financial position and transactions is presented. The FRSSE requires a Director's report to accompany the statement of accounts. IDBs should provide an annual report approved by the Board that includes such additional information that enables the user of the accounts to gain a better understanding of any matters set out in the accounts.
- 4.10 The FRSSE while recommending the voluntary disclosure of cash flow information states that this is not a mandatory requirement. All accounts should present both current and preceding accounting period information.
- 4.11 Although not a requirement of the FRSSE, where a Board is the sole managing trustee for a trust fund, a separate trust fund revenue account and balance sheet should be included in a note to the Board's financial statements.
- 4.12 If DEFRA or the Environment Agency require additional accounting information to be disclosed this can be included by way of a note to the accounts.
- 4.13 IDBs should use discretion in providing additional information over and above that required by proper practice that may be of interest to the users of the accounts, for example information about individual maintenance schemes or analyses of expenditure on each pumping station. Such information must be provided separately from the accounting statements and clearly excluded from those statements that are subject to the auditor's opinion and report.
- 4.14 IDBs should note however that if additional information is published with the financial statements it will be reviewed by the auditor in the same way as the annual report to identify any inconsistency with the audited financial statements.

### **Accounting Principles and Policies**

- 4.15 The financial statements state that they have been prepared in accordance with the FRSSE and this guidance and should include:

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<sup>7</sup> DCLG Circular 03/2006

- a description of each material accounting policy (see below);
- a statement (if necessary) detailing any changes to the accounting policies from one period to another, including reasons for change and an analysis of the financial effect of the change; and
- where the effect of a change to an estimation technique is material, a description of the change and where practicable the effect on the result for the current period.

4.16 When preparing the financial statements IDB should have regard to the following accounting principles:

**Going Concern:** IDBs are presumed to be carrying on their functions as a going concern. Any material uncertainties about this presumption should be disclosed.

**Prudence:** IDBs should determine any amount of any item on a prudent basis, that is to exercise a degree of caution when making estimates under conditions of uncertainty so that assets are not overstated and liabilities not understated.

**Accruals:** The financial statements shall be prepared on an accruals basis, in that all income and expenditure relating to the financial period to which the accounts relate shall be taken into account without regard to the date of payment or receipt.

**Relevance:** The financial statements should provide information about the Board's financial performance that is useful for assessing the stewardship of public funds and for making economic decisions.

**Consistency:** Consistent accounting policies should be applied both within the accounting period and between accounting periods. Where accounting policies are changed, the reason and effect should be separately disclosed.

**Reliability:** The financial information provided should be reliable and conform to the following:

- reflect the substance of the transactions and other events that have taken place;
- be free from deliberate or systematic bias;
- be free from material error;
- be complete within the bounds of materiality; and
- under conditions of uncertainty, be prudently prepared.

**Comparability:** The statement of accounts should be prepared with consistent and adequate disclosure to allow comparability.

**Understandability:** All reasonable efforts have been taken in preparation of the financial statements to ensure they are as easy to understand as possible.

**Materiality:** An item of information is material if its mis-statement or omission might reasonably be expected to influence assessments of the stewardship, economic decisions, or comparisons with other entities, based upon the financial statements.

- 4.17 Accounting policies and estimation techniques shall consistent with the FRSSE and be applied consistently within the same accounts and from one financial period to the next. If there is a material change in accounting policy the amounts for the current and corresponding periods shall be restated on the basis of the new policies by making prior period adjustments.
- 4.18 Prior Period adjustments shall be made by restating the comparative figures for the proceeding year and adjusting the opening balances of reserves accordingly. Where a statement of total recognised gains and losses has been prepared the cumulative amount should also be noted at the foot of the current period.

### **Accounting for Grants**

- 4.19 Revenue grants and subsidies should be credited to revenue accounts and accrual is made for balances known to be receivable at the end of the accounting period.
- 4.20 A government grant should not be taken to the income and expenditure account unless the conditions for its receipt have been met and there is reasonable assurance that it will be received.
- 4.21 Where the acquisition of a fixed asset is financed either wholly or in part by a government grant or other contribution, the amount of the grant or contribution should be deducted from the purchase price of the asset when recording the acquisition in the accounts for the first time.

### **Fixed Assets**

- 4.22 The FRSSE requires that expenditure on tangible fixed assets shall be measured at cost and the written down to its recoverable amount if necessary. Assets are defined as rights or other access to future economic benefit controlled by an IDB as a result of past transactions or events. The option of revaluing assets, although permitted by the FRSSE, is not recommended by the ADA.
- 4.23 All expenditure on the acquisition, creation or enhancement of fixed assets above a de minimus level should be recognised on a consistent basis and capitalised on an accruals basis in the accounts. Boards should therefore set an appropriate de minimus level for each category of asset and review this level from time to time.

- 4.24 The FRSSE provides for fixed assets to be classified as between research and development, intangible assets and goodwill; tangible fixed assets; investments (in companies) and investment properties. Boards are likely to only have tangible fixed assets (land & buildings, vehicle and plant) and some may hold investment properties. No specific sub-division into type of fixed assets is required. However if Boards consider the users of the financial statements should be provided with further information, a sub division of tangible fixed assets between land & buildings; vehicles & plant; and non-operational assets by way of a note to the accounts is suggested.
- 4.25 Tangible fixed assets should be recorded at historic cost and written down to a recoverable amount if less. In the event of the rare occurrence where historic cost is not known, the book value of an asset may be estimated by the Members of the Board on the basis of professional guidance. Assets valued in this way must be individually identified in asset registers and in the notes to the accounts

### **Depreciation**

- 4.26 All tangible fixed assets (other than investment properties) should be depreciated over their useful economic life on an appropriate basis. Land is regarded as having an unlimited life and is therefore not depreciated. Investment properties are not depreciated except where held on a lease with an unexpired term is 20 years or less.
- 4.27 The notes to the accounts should disclose the depreciation method applied and the useful economic lives of the assets.
- 4.28 For fixed assets other than non-depreciable land and non-operational investment properties, the only ground for not charging depreciation is that the depreciation charge is immaterial.
- 4.29 For simplicity, it is suggested that depreciation is provided by the straight line method so as to write off the cost of the relevant assets in equal installments over their useful lives. Depreciation should be provided over appropriate periods. However Boards should consider whether other more appropriate methods should be adopted depending on their circumstances. Changes to depreciation methods should be disclosed.
- 4.30 Depreciation should be borne by the income and expenditure account.

### **Leasing**

- 4.31 Leases take two forms. Finance leases are leases where the substantially all of the risks of ownership are transferred to the IDB, Operating leases are defined as any lease that is not a finance lease. If, at the inception of a lease, the present value of the minimum lease payments, including an initial payment amounts to substantially all

(normally 90% or more) of the fair value of the asset subject to lease it is normally presumed to be an operating lease.

- 4.32 Hire purchase contracts which are of a financing nature should be accounted on the basis similar to finance leases, while other hire purchase contracts should be treated as operating leases.
- 4.33 A finance lease should be recognised on the balance sheet both as an asset and as a liability -an obligation to pay future rentals. An asset held under a finance lease should be depreciated over the shorter of the lease term and its useful life.
- 4.34 The finance charge under a finance lease should be allocated to each accounting period over the lease term and a straight line method is reasonable,
- 4.35 Operating lease rentals should be charged to revenue on a straight line basis over the lease term whether or not this matches actual payments.

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

- 4.36 Stock and WIP should be included at the lower of cost or net realisable value

#### **Short Term Investments**

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

#### **Debtors**

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

Amounts falling under one year:  
Sundry Debtors (gross)  
Drainage Rate Debtors (gross)  
HM Revenues & Customs (VAT)

Amounts falling due after one year  
Officer's car loans

(less Provision for bad and doubtful debts).

## **Other short term liabilities**

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

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

- 4.40 Cash at bank should include current and deposit accounts as well as building society and similar deposits and petty cash.

## **Creditors**

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

## **Long Term Liabilities**

- 4.42 Long Term Borrowing: For those IDBs that have taken out loans to finance capital expenditure a note to the accounts showing the nature of the borrowing and an analysis of the maturity profile is required. For ease of reading this may be presented in a table within the note. The current portion of long term debt should be shown as a current liability.

## **Reserves**

- 4.43 Reserves are the net worth of the Board at the accounting date. Reserves should only include amounts held by the IDB as development contributions where such contributions are unconditional.
- 4.44 The disclosure of reserves reflects the historic financial position as at the end of the accounting period. Further analysis by IDBs into designated or undesignated reserves is entirely optional and should only be presented as note to the accounts.

## **Pensions**

- 4.45 Employees of the Boards are usually members of the Local Government Pensions Scheme, a statutory scheme, which provides members with defined benefits (retirement lump sums and pensions) related to pay and service. As such Boards should account for the retirement benefits on that basis. Where the Pension scheme is able to identify the share of the underlying assets and liabilities of the scheme that relate to the Board's employees it should prepare its accounts in accordance with the guidance issue at Appendix II of the Financial Reporting Standard for Smaller Entities (FRSSE) which provides guidance on the application of FRS 17. The guidance is available from the Financial Reporting Council at:  
[www.frc.org.uk/documents/pagemanager/asb/FRSSE-Jan2007%20web%20optimized.pdf](http://www.frc.org.uk/documents/pagemanager/asb/FRSSE-Jan2007%20web%20optimized.pdf)

- 4.46 Boards are expected to obtain the best information available in relation to meeting accounting standards. The cost of obtaining information is not a barrier. In the event that information is available from the pension scheme actuary valuing the Board's share of the pension scheme assets and liabilities, then this information must be applied in the preparation of the accounts in accordance with the requirements for defined contribution schemes.
- 4.47 In such cases the Board will need to incorporate assets or liabilities of the scheme in its accounts, arrange for actuarial valuations to do so and make a number of disclosures in relation to the scheme.
- 4.48 However as it is not always possible to identify the share of the underlying assets and liabilities of the scheme that relate to the Board's employees so it will not normally be possible to determine a fair value of the scheme attributable to the Board's employee. In such cases pension costs should be accounted for on the same basis as defined contribution schemes.
- 4.49 The cost of a defined contribution scheme is equal to the contributions payable to the scheme for the accounting period and should be recognised in the Income and Expenditure Account. The following disclosures should be made:
- the nature of the scheme
  - the cost for the period
  - any outstanding or prepaid contributions at the balance sheet date.

### **Post Balance Sheet Events**

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

## **Related Party Transactions**

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

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

- 4.56 The financial statements should be prepared in accordance with regulation 10 of the Accounts and Audit Regulations 2003 as amended and be signed and certified by the responsible financial officer and submitted for approval by the Board in accordance with the regulations.



## **Section 2 The Statements of Account in detail**

### **General Disclosure Requirements**

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

The financial statements shall include:

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

### **Annual Report**

4.58 The FRSSE requires the inclusion an annual report. It is a useful means of presenting detailed financial information in the context of the Board's operating environment. Boards should include an annual report but in doing so should note that it will not be subject to detailed audit review although auditors will report by exception if any inconsistency with the statements of account is noted. Preparers of accounts should ensure that there is consistency prior to presenting the accounts to the Board for approval. It should be approved by the Board and signed by the Chairman accordingly.

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

- 4.60 The FRSSE requires the following disclosures to be included in the Annual Report:
- A description of the principal activities of the IDB
  - Details of the Members of the Board
  - A statement describing the policy adopted in relation to disabled people (only required if over 250 employees)
- 4.61 The annual report should be concise, and restricted to significant matters. It should include such items that are likely to be significant to the understanding of the accounts such as:
- (a) An explanation of which statements follow, their purpose and the relationship between them.
  - (b) A comparison of expenditure with the original budget for the accounting period and explanation of significant variations
  - (c) A brief note of any major fixed asset acquisitions and disposals or material liabilities incurred
  - (d) An explanation of any material and unusual charge or credit in the accounts
  - (e) Any significant change in accounting policies. The reason for the change, and the effect on the accounts, should be explained
  - (f) Any major change in statutory functions which has a significant impact on the accounts. In addition, a comment on planned future developments in service delivery, including a summary of revenue and capital investment plans, distinguishing between expenditure intended to maintain existing levels of service provision and that intended to expand existing services or develop new services
  - (g) A brief note of the Board's current borrowing facilities and capital borrowing, outlining the purpose and impact of financing transactions entered into during the year.
  - (h) A summary of the Board's internal and external sources of funds available to meet its capital expenditure plans and other financial commitments.

### **Annual Governance Statement**

- 4.62 The Accounts and Audit Regulations require Boards to conduct an annual review of the effectiveness of its systems of internal control and to include a statement on internal control, prepared in accordance with proper practices with its accounting statements.

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

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

4.64 The statement should be signed by the chairman of the Board and the chief executive officer or clerk of the Board. The minimum amount of disclosure required in the annual governance statement is the same as that contained in the annual return used by smaller IDBs (see above paragraphs 2.29 to 2.38). Larger Boards may wish to apply the guidance contained in CIPFA's Delivering Good Governance in Local Government published in June 2007.

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

4.65 The statement of responsibilities should:

- Acknowledge the Board's responsibilities for the proper administration of its financial affairs and the appointment of a responsible financial officer (RFO);
- Acknowledge the Board is required to manage its affairs to secure economic, efficient and effective use of its resources;
- Set out the RFO's responsibilities for the preparation of the accounts regarding the selection and application of appropriate accounting policies, for estimation techniques and compliance with generally accepted accounting practice, the maintenance of proper records and steps taken to prevent and detect irregularities; and
- The statement should be signed and dated by the Responsible Finance Officer

## Statement of Accounting Policies and Estimation Techniques

4.66 The statement should include the following:

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

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

## **The Income and Expenditure Account**

- 4.68 The Income and Expenditure account should include information for both current and prior year accounting periods.
- 4.69 Revenue arises from drainage rates, levies, grants, rechargeable works, interest and other investment income and sundry activities.
- 4.70 The ADA recommend that the analysis of income and expenditure should contain a summary of the main fund raising and spending areas:

### **Income**

- Drainage Rates
- Special Levies on Councils
- Grants Received
- Rental Income
- Interest and Investment Income
- Income from Rechargeable Works
- New Works and Improvement Contributions
- Other Contributions

### **Expenditure**

- Environment Agency precept
- Pumping Stations
- Drains Maintenance
- Administration Costs
- The Cost of Rechargeable Works
- Office and Depot Maintenance Costs
- Costs of Borrowing

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

- Profits or Losses on disposal of fixed assets

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

### **Disclosure Notes to the I & E Accounts**

1. Special levies showing the breakdown by local authority:  
Where more than one local authority is subject to a levy a note it is recommended that a note be provided showing the relevant contributions by each authority.

2. An analysis of Government grants received: Grants may be received from DEFRA or the Environment Agency (such as for “foreign water” in IDB drains). The nature and the amount of grants received should be identified where material.
3. Information about the Pension Scheme offered to employees identifying the administering authority, the nature of the scheme, the cost for the period and the amount of any outstanding or prepaid contributions at the balance sheet date.
4. Disclosure of remuneration of senior staff earning over £50,000 per annum in bands of £10,000 with current year and previous year numbers of employees<sup>8</sup>.
5. Audit Fees and expenses
6. Related Party Transactions

Boards should disclose related party transactions that are material to the Board’s accounts including the

- name of related parties
- a description of the relationship
- the amounts involved
- any other elements of the transaction necessary for an understanding of the financial statements
- the amounts due to or from related parties at the balance sheet date and any provisions for doubtful debts at that date and
- any amounts written off in the accounting period in respect of debts due from related parties.

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

- 4.71 This statement reconciles the change in reserves between accounting periods

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

- 4.72 Where it is prepared, the presentation of a statement of total recognised gains and losses should have the same prominence as the income and expenditure Account. The statement should include all gains and losses that are not included in the income and expenditure account such as surplus or deficit arising on revaluation of fixed assets.
- 4.73 In the case of IDBs who account for assets on an historic cost basis and account for pensions on a defined contribution basis it is likely that all gains and losses will have been recognised in the income and expenditure account and therefore this statement will not be required.

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<sup>8</sup> This is a requirement of regulation 7(2)(b) the Accounts and Audit Regulations 2003 as amended and is additional to the requirements of the FRSSE.

4.74 If required, the format of the statements is:

- Surplus or deficit on the Income and Expenditure Account
- Surplus or deficit on the revaluation of fixed assets
- Actuarial gains or losses on pension fund assets or liabilities (not required for Boards accounting for pension funds on a defined contribution basis)
- Any other gains or losses.

4.75 Current accounting period and prior period comparatives are required.

## **The Balance Sheet**

### **+ Intangible Assets (if any)**

### **+Fixed Assets**

Land and Buildings  
Vehicles and Plant  
Non – operational assets

### **+Current Assets**

Stock and Work in Progress  
Debtors and Prepayments  
Short term Investments  
Cash at bank and in hand

### **-Current Liabilities**

Creditors and Receipts in Advance  
Cash Overdrawn

### **=Net Current Assets**

### **=Total Assets less Current Liabilities**

### **-Long Term Borrowing**

### **=Total Assets less liabilities**

### **= Reserves**

General Reserves

## **Disclosure Notes to the Balance Sheet**

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

The accounts should also disclose:



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

Note: Investment properties are not depreciated

### 3. Leases:

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

## **The Auditor's Report**

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

**Section 3 An outline statement of accounts for XYZ IDB**

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## **XYZ IDB**

### **Annual Report**

The XYZ IDB is an independent body created under land drainage statutes responsible for flood defence works, other than on main rivers, in the XYZ area. Board Members are either elected by and represent the occupiers of land in the area or our nominated by XYZ and ZXY District Councils.

The Board secures income mainly from drainage levies on farmers and other occupiers and from special levies on local authorities. The Board also pays levies to the Environment Agency to fund works on main rivers that protect our area.

The Board consists of xx elected members and xx nominated members. Further details are attached at page xx.

This document is the statement of accounts of XYZ IDB for the financial year ended 200y/0z which are set out on pages x to z. The accounts consist of:

#### The Auditor's Report

#### The Annual Governance Statement

#### The Statement of Responsibilities

This statement identifies the officer who is responsible for the proper administration of the Board's financial affairs.

#### The Statement of Accounting Policies

This statement details the legislation and source of accounting principles on which the financial statements are prepared

#### The Income and Expenditure Account

This statement shows the gross expenditure, income and net expenditure on the major activities for which the Board is responsible and compares that cost with the finance provided by the local rate payer and others.

#### The Statement of Movement on Reserves

This statement shows the changes in reserves

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

This statement shows all gains and losses including those which are not included in the Income and Expenditure Account<sup>9</sup>

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<sup>9</sup> Only required if gains and losses not included in the Income and Expenditure Account exist.

## The Balance Sheet

This statement is fundamental to the understanding of the Board's financial position at the year end. It shows the balances and reserves at the Board's disposal; and the fixed and net current assets employed in its operation, together with summarised information on the fixed assets held. The statement also includes assets and liabilities of the Board

## Summary of Financial Performance

The Board's financial position improved/worsened in the year end as a result of the following .....

The expenditure outturn for the year exceeded budgeted expenditure for the year due to the additional works required after the exceptionally bad weather in June 200x.

The Board completed the major improvements at the xyz at a final outturn of £xxx. However some major capital works due to have commenced in xxxx. 200x were delayed because...

The Board has acquired the following major items of plant as part of a planned programme of vehicle and plant replacement.....

The Board has embarked on a three year development plan in relation to the river xzy area which will require capital investment of over £ in the period. This will be funded from reserves (£), DEFRA grant (£) later by additional borrowing (£) from the PWLB in future years.

## The Annual Governance Statement

We acknowledge as the members of the XYZ Inland Drainage Board our responsibility for ensuring that there is a sound system of internal control, including the preparation of the statement of accounts, and confirm, to the best of our knowledge and belief, with respect to the Board's statement of accounts for the year ended 31 March 200z, that:

1. We have approved the statement of accounts which has been prepared in accordance with the requirements of the Accounts and Audit Regulations and proper practices.
2. We have maintained an adequate system of internal control, including measures designed to prevent and detect fraud and corruption, and reviewed its effectiveness.
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 board to conduct its business or on its finances.
4. We have provided proper opportunity during the year for the exercise of electors' rights in accordance with the requirements of the Accounts and Audit Regulations.
5. We have carried out an assessment of the risks facing the Board and taken appropriate steps to manage those risks, including the introduction of internal controls and/or external insurance cover where required.
6. We have maintained throughout the year an adequate and effective system of internal audit of the board's accounting records and control systems and carried out a review of its effectiveness.
7. We have taken appropriate action on all matters raised in previous reports from the internal and external audit.
8. We have considered whether any litigation, liabilities or commitments, events or transactions, occurring either during or after the year-end, have a financial impact on the board and where appropriate have included them in the statement of accounts. **o\***

**'Yes'**

This annual governance statement is approved by the board and recorded as board minute reference dated .....

Signed on behalf of xzy Inland Drainage Board

Signed by: Chair

Date

Signed by: Responsible Financial Officer

Date

**MM/YYYY**

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

The Board is required:

- To make arrangements for the proper administration of its financial affairs and to secure that one of its officers has the responsibility for the administration of those affairs. In this the Board that officer is the Responsible Financial Officer.
- To manage its affairs to secure economic efficient and effective use of its resources and safeguard its assets

The Responsible Financial Officer's Responsibilities:

The Responsible Financial Officer is responsible for the preparation of the Board's Statement of Accounts which is required to present a true and fair view of the financial position of the Board at the accounting date and its income and expenditure for the year ended 31 March 200z.

In preparing this statement of accounts, the Responsible Financial Officer has:

- selected suitable accounting policies and then applied them consistently;
- made judgements and estimates that were reasonable and prudent;
- compiled the accounts in accordance with the Financial Reporting Standard for Smaller Entities 2007 issued by the Accounting Standards Board and had regard to the guidance published by the Association of Drainage Authorities on Accounting for Larger IDBs;
- applied the accounting concept of a "going concern" by assuming that the IDB will continue to operate for the foreseeable future.

The Responsible Financial Officer has:

- kept proper accounting records which were up to date;
- taken reasonable steps for the prevention and detection of fraud and other irregularities.

Certificate of the Responsible Financial Officer

This statement of accounts is that upon which the auditor should enter his certificate and opinion. It provides a true and fair view of the financial position of the Board at 31 March 200z and its income and expenditure for the year then ended.

Certificate of the Chairman of the Board

I confirm that these accounts has been approved by the xyz IDB at a meeting held on xx.xxxx.xxxx.

## Statement of Accounting Policies

### General

1. This statement of accounts has been prepared in accordance with the Financial Reporting Standard for Smaller Entities 2007 (FRSSE) issued by the Accounting Standards Board. In preparing the statements regard has been had to the Guidance published by the Association of Drainage Authorities.
2. These accounts have been prepared in accordance with the following accounting concepts
  - Accruals
  - Relevance
  - Consistency
  - Reliability
  - Comparability
  - Understandability
  - Materiality and
  - Going Concern.

### Fixed assets

3. Fixed Assets are recognised as expenditure on the acquisition, creation or enhancement of fixed assets with a value in excess of £5,000 and with estimated useful lives in excess of one year are capitalised on an accruals basis in the accounts.
4. All fixed Assets are valued on the following basis
  - Land and buildings are included in the balance sheet at cost or net realisable value if lower.
  - Vehicles, plant and equipment are included at cost less depreciation
5. Disposals are written off at cost less depreciation. Any surplus/deficit arising is charged/credited to the Income and Expenditure Account.
6. Depreciation has been provided for, using the straight line method, on office equipment, computer equipment and furniture with a purchase cost in excess of £5,000.

The useful lives of the various assets held on the Asset Register are as follows:

- Motor vehicles and Equipment: x years
- Excavators and Plant:
- Office equipment
- Computer equipment
- Furniture

### **Stocks and work in progress**

7. Stocks and work in progress are valued at the lower of cost or net realisable value.

### **Government grants and subsidies**

8. Government grants and contributions have been credited to the income and expenditure account on an accruals basis. Government Grant used for the acquisition of fixed assets have been deducted from the purchase price of the asset.

### **Operating Leases**

9. Rentals payable, net of benefits received or receivable, under operating leases are charged to expenditure on a straight-line basis over the term of the lease.

### **Provisions**

10. The Board sets aside provisions where there is a definite liability, but the amount and timing of settlement is not known. Details are given as notes to the accounting statements.

### **Pensions**

11. Pension costs are accounted for on a defined contribution basis as it is not possible to identify the share of assets belonging to the Board in the ZZZ Pension Fund.

### **Post balance sheet events**

12. Any material post balance sheet events, which did not exist at the date of the balance sheet, have been disclosed as a separate note to the accounts.

### **Taxation**

13. Drainage Boards are exempt from Income, Corporation and Capital Gains Taxes. Value Added Tax is included in the accounts only to the extent that it is irrecoverable.

### **Exceptional items, extraordinary items and prior year adjustments**

14. There are no material exceptional or extraordinary items to disclose in the accounts. There are no material prior period adjustments in the accounts.



## **Discontinued operations**

15. The Board had no material operations which it acquired or which were discontinued in the year and therefore no separate disclosure is required in respect of the revenue and balance sheet accounts.

## XYZ Inland Drainage Board

### Income and Expenditure Account

200x/y £		200y/z £	£	Notes
	<b>Income</b>			
	Drainage Rates			
	Special Levies on Councils			1
	Grants received			2
	Rental Income			
	Income from rechargeable works			
	Interest and Investment Income			
	New Works and Improvement			
	Other Contributions			
	<b>Expenditure</b>			
	Environment Agency precept			
	Pumping Stations			
	Drains Maintenance			
	Administration costs			
	The Cost of Rechargeable works			
	Office and Depot Maintenance costs			
	Costs of Borrowing			
	<b>Exceptional Items</b>			
	Profits or losses arising from the disposal of assets			
	<b>Net Operating Surplus or deficit for year</b>			

### **Statement on the Movement on Reserves**

Surplus or deficit for the year in  
the Income and Expenditure  
Account  
Opening reserves  
Closing Reserves

### **Statement of Total Recognised Gains and Losses<sup>10</sup>**

Surplus or deficit for the year in  
the Income and Expenditure  
Account  
Other gains and losses  
Total Recognised Gains and  
Losses

---

<sup>10</sup> If required

**XYZ Inland Drainage Board**  
**Balance Sheet as at 31 March 200z**

**200x**  
**£**

**200y**  
**£      £**

**Notes**

**Tangible Fixed Assets**

Land and Buildings

Vehicles and Plant

Non Operational Assets (Investment Properties)

**Current Assets**

Stock and Work in Progress

Debtors and Prepayments

Short Term Investments

Cash at bank and in hand

**Current Liabilities**

Creditors and Receipts in Advance

Borrowing Payable in less than 12 months

Cash Overdrawn

**Net Current Assets**

**Total Assets less Current Liabilities**

**Long Term Borrowing**

**Total Assets less Liabilities**

**Reserves**

## Notes to the Accounts

1) Special levies

	2000y £'000	200x £'000
XYZ DC		
ZXY DC		

2) Government grants received from DEFRA

	2000y £'000	200x £'000
Scheme A		
Scheme B		

3) Pension Fund Contributions: The Board pays an employers contribution of x.xx% of the superannuable employees' reckonable pay into the xyz County Council Pension Fund. The cost for the period is accounted for as a defined contribution scheme and amounted to £xxx for the year .No amounts were owed or prepaid at 31 March 200z

The Annual Report of the Pension Fund is available from:

4) Remuneration of Employees:

This table indicates the number of employees whose remuneration was greater than £50,000. (Remuneration being amounts paid or receivable by an employee, including payments in kind, but pensions contributions paid by an employee or employer are excluded:

Remuneration Band £	Number of Employees	
	200y/z	200x/y
50,000 – 59,999		
60,000 - 69,999		
70,000 – 79,999		

5) Audit Fees and Expenses

The fees paid to the Board's external auditors for 200y/z were £ x,xxx (200x/y £x,xxx)

6) Related Party Transactions

The Board rents premises from Mr x a board member at £ per annum

7) Post balance sheet events

On April 2<sup>nd</sup> 200z the Board's depot was partly destroyed by fire. It is included in the accounts at a historic cost of £xx,xxx. It is covered by insurance and is the repair costs are expected to fully recovered.

8) Tangible Fixed Assets

<b>Cost</b>	<b>Land and Buildings</b>	<b>Vehicle and Plant</b>	<b>Total</b>
Opening balance			
Disposals			
Additions			
As at 31/3/200z			

**Depreciation**

Opening Balance  
Disposals  
Charge for year

As at 31/3/200z

**Net Book Value at 31/3/0x**

**Net Book Value at 31/03/0z**

9) Stocks and WIP

	<b>200z</b>	200x
Stocks -		
WIP (Rechargeable works)		

10) Debtors and payments in advance

	<b>200z</b>	200x
Trade Debtors		

Drainage Rate Debtors		
HM Revenue and Customs (VAT)		
Amounts falling due within one year		
Other Debtors falling due after one year		

- 11) Short Term Investments
- 12) Creditors and Receipts in Advance

	<b>200z</b>	200x
Sundry Creditors		
Development Contributions paid in advance		
Grants paid in Advance		

## Glossary

Accounts and Audit Regulations 2003 as amended	Secondary legislation governing the arrangements for preparing and auditing the accounts of local authorities. Supported by DCLG (formerly ODPM) Circular 04/2003. Updated by the Accounts and Audit (Amendment) Regulations 2006. Supported by DCLG (formerly ODPM) Circular xx/2006 still to be published.
Annual return	The return, specified by the Audit Commission, is the means by which Internal Drainage Boards report to the public their statement of accounts, provide a statement of assurance in relation to key financial aspects of corporate governance and present the external auditor's opinion on the annual return. In addition the annual return includes a report from the Board's internal auditor (this does not have to be published).
Annual Report	The statutory annual report to Defra required by Section 4 of Schedule 2 to the Land Drainage Act 1991. Contains key financial information about Special Levies and other taxation and reports performance against national high level targets set for Boards from time to time by Defra.
Appointed auditor	The external auditor appointed by the Audit Commission.
Code of Audit Practice	Prepared and issued by the Audit Commission, this code is laid before Parliament at least every five years and provides the framework within which external auditors must carry out their audits.
Corporate governance	The arrangements by which authorities direct their functions and relate to their communities.
Internal audit	A function, within or procured by the Board, which is to review and report on the effectiveness of internal controls.
Internal control	An activity, process, system or measure to ensure that a local Board's activities are carried out properly and as intended.
Internal control environment	The overall framework of internal controls and a key element in good corporate governance.
Internal Drainage Boards	See part 1 of the guidance for definitions.



Representation	An assertion made within the annual return – see statement of assurance.
Responsible financial officer (“RFO”)	The officer designated by the Board to ensure that the Board maintains adequate accounting arrangements.
Risk management	The arrangements which a Board makes to identify key business risks, evaluate these and put in place to measures to reduce the risk or manage the consequences of its occurrence.
Statement of accounts	The section (1) in the annual return which summarises the financial results of the Board.
Statement of assurance	A statement by the Board which forms part of the annual return (section 2) and meets the statutory requirement for an annual Statement on Internal Control. It sets out representations or assertions intended to give the public assurance about the way in which the Board has exercised key aspects of corporate governance.
Ultra vires	Any activities which are beyond the powers of the local Board, and so unlawful, are said to be ultra vires.
Virement	Approved transfers of expenditure from one budget head to another.

## Appendix 1

### Internal Drainage Boards – statutory services and powers

<b>INTERNAL DRAINAGE BOARDS - services and powers</b>		
<b><u>Function</u></b>	<b><u>Powers &amp; Duties</u></b>	<b><u>Statutory Provisions</u></b>
Land Drainage	<ul style="list-style-type: none"> <li>☞ general supervision over all aspects of land drainage within the district</li> <li>☞ improving and maintaining the drainage system, including the operation of pumping stations</li> <li>☞ regulating activities in and alongside the drainage system, other than on those waterways designed as main river and under the Environment Agency's control</li> <li>☞ duties to conservation</li> <li>☞ raising income to support land drainage works</li> </ul>	Land Drainage Act 1991
Byelaws	Powers to make byelaws in regard to Land Drainage	Land Drainage Act 1991
Investments	Duty of Care	Trustees Act 2000
Land	<ul style="list-style-type: none"> <li>Power to acquire by agreement to appropriate to dispose of land</li> <li>Power to accept gifts of land</li> </ul>	Land Drainage Act 1991
Public buildings	Power to provide and contribute to buildings for offices	Land Drainage Act 1991

Governance and Accountability in Internal Drainage Boards in England:  
A Practitioners' Guide 2006

## **Appendix 2**

# **Statement of Responsibilities of Auditors and of Audited Bodies**

[Click here](#) for an accessible version on the Audit Commission's website

Corporate

March 2005



# **Statement of responsibilities of auditors and of audited bodies**

**The Audit Commission** is an independent body responsible for ensuring that public money is spent economically, efficiently and effectively, to achieve high-quality local and national services for the public. Our remit covers more than 15,000 bodies which between them spend nearly £125 billion of public money every year. Our work covers local government, housing, health, criminal justice and fire and rescue services.

As an independent watchdog, we provide important information on the quality of public services. As a driving force for improvement in those services, we provide practical recommendations and spread best practice. As an independent auditor, we monitor spending to ensure public services are good value for money.

For further information on the work of the Commission please contact:

Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ Tel: 020 7828 1212

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## General introduction

- 1 The Audit Commission (the Commission) is responsible for appointing auditors and determining their terms of appointment, as well as for preparing a *Code of Audit Practice*, which prescribes the way in which auditors are to carry out their functions. The Commission has prepared a *Code* for the audits of local government bodies and a *Code* for the audit of local NHS bodies. From time to time, the Commission issues guidance to auditors under section 3(8) of the Audit Commission Act 1998 (the Act) and paragraph 7 of Schedule 1 to the Act. This statement sets out guidance on general responsibilities relevant to audits in both sectors and so supports each *Code*.
- 2 The purpose of this statement is to assist auditors and audited bodies by summarising where – in the context of the usual conduct of an audit – the different responsibilities of auditors and of the audited body begin and end, and what is to be expected of the audited body in certain areas. Throughout this statement, the term ‘audited body’ covers both the members of the body (for example, elected members in local authorities and directors of NHS bodies) and its management (the senior officers of the body).
- 3 The responsibilities of auditors are derived from statute (principally the Audit Commission Act 1998) and from the *Code*. Nothing in this statement is intended to limit or extend those responsibilities. In particular, audited bodies should note that, because auditors must not prejudice their independence of the audited body, the audit role does not include providing financial or legal advice or consultancy to the audited body.
- 4 Auditors may wish to refer to, and/or incorporate, this statement in audit planning documents, annual audit letters, reports and other audit outputs.

## Introduction to responsibilities

- 5 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.
- 6 In discharging this accountability, public bodies and their management (both members and officers) are responsible for putting in place proper arrangements for the governance of their affairs and the stewardship of the resources at their disposal. They are also required to report on their arrangements in their annual published Statements on Internal Control.
- 7 It is the responsibility of the audited body to ensure that proper arrangements are in place, but certain individuals have specific responsibilities. In NHS bodies there is a unitary board, consisting of executive members and part-time non-executive members, chaired by a non-executive member. The chairman and non-executive members are responsible for monitoring the executive management of the body and are responsible to the Secretary of State for the discharge of these responsibilities. In addition, there is a requirement for an audit committee, which contributes independently to the board's overall process for ensuring that an effective internal control and risk management system is maintained. The chief executive is responsible to the board for the day-to-day management of the organisation and, as accountable officer, is also responsible to the Department of Health for the proper stewardship of public money and assets. Local authorities have three designated statutory officers, each of whom has a specific role in relation to accountability and control:
  - head of paid service – usually the chief executive, responsible to the full council for the corporate and overall strategic management of the authority;
  - monitoring officer – responsible for reporting to the authority any actual or potential breaches of the law or any maladministration, and for ensuring that procedures for recording and reporting key decisions are operating effectively; and
  - chief financial officer – with responsibility for the proper administration of their financial affairs.
- 8 In carrying out their responsibilities, auditors may wish to obtain representations from management, both orally and in writing, on important matters.
- 9 The following paragraphs summarise the responsibilities of auditors and of audited bodies in relation to the responsibilities of auditors described in the *Code*.



## Auditing the financial statements

- 10** The financial statements, which comprise the published accounts of the audited body, are an essential means by which it accounts for its stewardship of the resources at its disposal and its financial performance in the use of those resources. It is the responsibility of the audited body to:
- put in place systems of internal control to ensure the regularity and lawfulness of transactions;
  - maintain proper accounting records; and
  - prepare financial statements that present fairly (or, for specified NHS bodies and for local probation boards, give a true and fair view of) the financial position of the body and its expenditure and income.
- 11** The audited body is also responsible for preparing and publishing with its financial statements a statement on internal control.
- 12** Auditors audit the financial statements and give their opinion, including:
- (a) whether they present fairly, or give a true and fair view of, the financial position of the audited body and its expenditure and income for the year in question;
  - (b) whether they have been prepared properly in accordance with relevant legislation and applicable accounting standards; and
  - (c) for certain bodies, on the regularity of their expenditure and income.
- 13** In carrying out their audit of the financial statements, auditors will have regard to the concept of materiality.
- 14** Subject to the concept of materiality, auditors provide reasonable assurance that the financial statements:
- (a) are free from material misstatement, whether caused by fraud or other irregularity or error;
  - (b) comply with statutory and other applicable requirements; and
  - (c) comply with all relevant requirements for accounting presentation and disclosure.

- 15 Auditors examine selected transactions and balances on a test basis and assess the significant estimates and judgements made by the audited body in preparing the statements.
- 16 Subject to the concept of materiality, auditors of specified NHS bodies and local probation boards also provide reasonable assurance on the regularity of expenditure and income. In giving such assurance, auditors do not perform detailed tests of transactions to the extent that would be necessary to disclose all unlawful transactions or events that may have occurred or might occur, and the audit process should not be relied upon to disclose such matters.
- 17 Auditors evaluate significant financial systems, and the associated internal financial controls, for the purpose of giving their opinion on the financial statements. Where auditors identify any weaknesses in such systems and controls, they will draw them to the attention of the audited body, but they cannot be expected to identify all weaknesses that may exist.
- 18 Auditors review whether the statement on internal control has been presented in accordance with relevant requirements and report if it does not meet these requirements or if it is misleading or inconsistent with other information of which the auditor is aware. In doing so auditors take into account the knowledge of the audited body gained through their work in relation to the audit of the financial statements and through their work in relation to the body's arrangements for securing economy, efficiency and effectiveness in the use of its resources. Auditors are not required to consider whether the statement on internal control covers all risks and controls, nor are auditors required to form an opinion on the effectiveness of the audited body's corporate governance procedures or risk and control procedures.

## Responsibilities in relation to arrangements for securing economy, efficiency and effectiveness in the use of resources

- 19** It is the responsibility of the audited body to put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, and to ensure proper stewardship and governance, and regularly to review the adequacy and effectiveness of them. Such corporate performance management and financial management arrangements form a key part of the system of internal control and comprise the arrangements for:
- establishing strategic and operational objectives;
  - determining policy and making decisions;
  - ensuring that services meet the needs of users and taxpayers and for engaging with the wider community;
  - ensuring compliance with established policies, procedures, laws and regulations;
  - identifying, evaluating and managing operational and financial risks and opportunities, including those arising from involvement in partnerships and joint working;
  - ensuring compliance with the general duty of best value, where applicable;
  - managing its financial and other resources, including arrangements to safeguard the financial standing of the audited body;
  - monitoring and reviewing performance, including arrangements to ensure data quality; and
  - ensuring that the audited body's affairs are managed in accordance with proper standards of financial conduct, and to prevent and detect fraud and corruption.
- 20** The audited body is responsible for reporting on these arrangements as part of its annual statement on internal control.
- 21** Auditors have a responsibility to satisfy themselves that the audited body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. In meeting this responsibility auditors should review and, where appropriate, examine evidence that is relevant to the audited body's corporate performance management and financial management arrangements, as summarised above, and

report on these arrangements. Auditors of specified local government bodies (best value authorities) also have a responsibility to consider, and report on, the audited body's compliance with statutory requirements in respect of the preparation and publication of its best value performance plan.

- 22** Auditors are responsible for reporting annually their conclusion, having regard to relevant criteria specified by the Audit Commission, as to whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. Auditors report if significant matters have come to their attention that prevent them from concluding that the audited body has put in place proper arrangements. However, auditors are not required to consider whether aspects of the audited body's arrangements for securing economy, efficiency and effectiveness in its use of resources are effective.
- 23** In planning their audit work in relation to the arrangements for securing economy, efficiency and effectiveness in the use of resources, auditors consider and assess the relevant significant business risks. These are the significant operational and financial risks to the achievement of the audited body's statutory functions and objectives, which apply to the audited body and are relevant to auditors' responsibilities under the *Code*, and the arrangements it has put in place to manage these risks. The auditor's assessment of what is significant is a matter of professional judgement and includes consideration of both the quantitative and qualitative aspects of the item or subject matter in question. Auditors discuss their assessment of risk with the audited body.
- 24** When assessing risk auditors consider:
- the relevance and significance of the potential business risks faced by all bodies of a particular type;
  - other risks that apply specifically to individual audited bodies;
  - the audited body's own assessment of the risks it faces; and
  - the arrangements put in place by the body to manage and address its risks.
- 25** In assessing risks auditors have regard to:
- evidence gained from previous audit work, including the response of the audited body to previous audit work;

- the results of assessments of performance carried out by the Commission;
  - the work of other statutory inspectorates; and
  - relevant improvement needs, identified in discussion with the Commission or other statutory inspectorates.
- 26** Where auditors rely on the reports of statutory inspectorates as evidence relevant to the audited body's corporate performance management and financial management arrangements, the conclusions and judgements in such reports remain the responsibility of the relevant inspectorate or review agency.
- 27** In reviewing the audited body's arrangements for its use of resources, it is not part of auditors' functions to question the merits of the policies of the audited body, but auditors may examine the arrangements by which policy decisions are reached and consider the effects of the implementation of policy. It is the responsibility of the audited body to decide whether and how to implement any recommendations made by auditors and, in making any recommendations, auditors should avoid any perception that they have any role in the decision-making arrangements of the audited body.
- 28** While auditors may review audited bodies' arrangements for securing economy, efficiency and effectiveness in the use of resources, they cannot be relied on to have identified every weakness or every opportunity for improvement. Audited bodies should consider auditors' conclusions and recommendations in their broader operational or other relevant context.
- 29** Auditors are not required to report to audited bodies on the accuracy of performance information that the audited bodies publish. Auditors' work is limited to a review of the systems put in place by the audited body to collect, record and publish the information, in accordance with guidance issued by the Commission. Nor are auditors required to form a view on the completeness or accuracy of the information or the realism and achievability of the assessments published by those audited bodies that are required to prepare best value performance plans.
- 30** Audit work in relation to the audited body's arrangements to ensure that its affairs are managed in accordance with proper standards of financial conduct, and to prevent and detect fraud and corruption, does not remove the possibility that breaches of proper standards of financial conduct, or fraud and corruption, have occurred and remained undetected. Nor is it auditors' responsibility to prevent or detect breaches of proper standards of financial conduct, or fraud and corruption, although they will be alert to the possibility and will act promptly if grounds for suspicion come to their notice.

- 31** The reviews arising from national studies developed by the Commission, or in support of the Healthcare Commission's national work programme, and the extent to which auditors are expected to apply them at relevant bodies, are prescribed by the Commission and are notified to audited bodies each year by the Commission in its annual work programme and by auditors in their audit planning documents. When carrying out national studies, auditors are required to follow the methodologies and, for certain studies, use comparative data provided by the Commission. Responsibility for the adequacy and appropriateness of these methodologies and the data rests with the Commission.

## Specific powers and duties of auditors

- 32** Auditors have specific powers and duties under the Audit Commission Act 1998 in relation to matters of legality and, in local government, electors' rights. Fees arising in connection with auditors' exercise of these powers and duties, including costs relating to the appointment of legal or other advisers to the auditors, are borne by the audited body.

## Reporting the results of audit work

- 33** Auditors provide:
- (a) an audit planning document;
  - (b) oral and/or written reports or memoranda to officers and, where appropriate, members on the results of, or matters arising from, specific aspects of auditors' work;
  - (c) a report to those charged with governance summarising the work of the auditor;
  - (d) an audit report, including the auditor's opinion on the financial statements and a conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources. For best value authorities this conclusion incorporates the auditor's report on the audit of the best value performance plan;
  - (e) a certificate that the audit of the accounts has been completed in accordance with statutory requirements; and
  - (f) an annual audit letter or, for those bodies where the Commission carries out inspections, information to be reported to the Commission in a specified format to enable it to prepare an annual audit and inspection letter to the audited body.

- 34 In addition, the following outputs, the need for which may arise at any point during the audit process, are issued where appropriate:
- (a) a report dealing with any matter that the auditor considers needs to be raised in the public interest under section 8 of the Act;
  - (b) any recommendations under section 11(3) of the Act (local government bodies);
  - (c) any referral to the Secretary of State under section 19 of the Act (local NHS bodies) where the auditor considers that a decision by a body or officer has led to, or would lead to, unlawful expenditure, or that some action by a body or officer has been, or would be, unlawful and likely to cause a loss or deficiency; and
  - (d) information to be reported to the Commission in a specified format to enable it to carry out any of its other functions, including assessments of performance at relevant bodies, or to assist other bodies, such as the Healthcare Commission, the Commission for Social Care Inspection and the National Audit Office, in carrying out their functions.
- 35 When considering the action to be taken on audit reports, audited bodies should bear in mind the scope of the audit and responsibilities of auditors, as set out in the *Code* and as further explained in this statement. Matters raised by auditors will be drawn from those that come to their attention during the audit. The audit cannot be relied upon to detect all errors, weaknesses or opportunities for improvements in management arrangements that might exist. Audited bodies should assess auditors' conclusions and recommendations for their wider implications before deciding whether to accept or implement them.
- 36 Although annual audit letters and reports may be addressed to officers or members of the audited body, they are prepared for the sole use of the audited body. Auditors do not have responsibilities to officers or members in their individual capacities (other than in the exercise of auditors' specific powers and duties in relation to matters relating to electors' rights in local government) or to third parties that choose to place reliance upon the reports from auditors.

## Ad hoc requests for auditors' views

- 37** There may be occasions when audited bodies will seek the views of auditors on the legality, accounting treatment or value for money of a transaction before embarking upon it. In such cases, auditors will be as helpful as possible, but are precluded from giving a definite view in any case because auditors:
- must not prejudice their independence by being involved in the decision-making processes of the audited body;
  - are not financial or legal advisers to the audited body; and
  - may not act in any way that might fetter their ability to exercise the special powers conferred upon them by statute.
- 38** In response to such requests, auditors can offer only an indication as to whether anything in the information available to them at the time of forming a view could cause them to consider exercising the specific powers conferred upon them by statute. Any response from auditors should not be taken as suggesting that the proposed transaction or course of action will be exempt from challenge in future, whether by auditors or others entitled to raise objection to it. It is the responsibility of the audited body to decide whether to embark on any transaction.

## Access to information

- 39** Auditors have wide-ranging rights of access to documents and information in relation to the audit. Such rights apply not only to documents and information held by the audited body and its members and staff, but also to the audited body's partners and contractors, whether in the public, private or voluntary sectors. However, there are strict restrictions on the disclosure of information obtained in the course of the audit, subject only to specific exemptions. The Freedom of Information Act 2000 does not apply to the Commission's appointed auditors, as they have not been designated as 'public authorities' for the purposes of that legislation.



## Grant claims and returns – certification

- 40 The Commission agrees to make certification arrangements in accordance with the framework set out in the separate *Statement of responsibilities of grant-paying bodies, authorities, the Audit Commission and appointed auditors in relation to claims and returns* (April 2004). The responsibility for ensuring the completion, accuracy and completeness of grant claims and returns lies with the audited body. Grant-paying bodies may require independent examination as a condition of their acceptance of claims and returns and may ask the Commission to make arrangements for auditor certification of claims and returns. The Commission will have regard to what it is appropriate, practically and professionally, to expect the certification process and auditors to do before agreeing to make certification arrangements.

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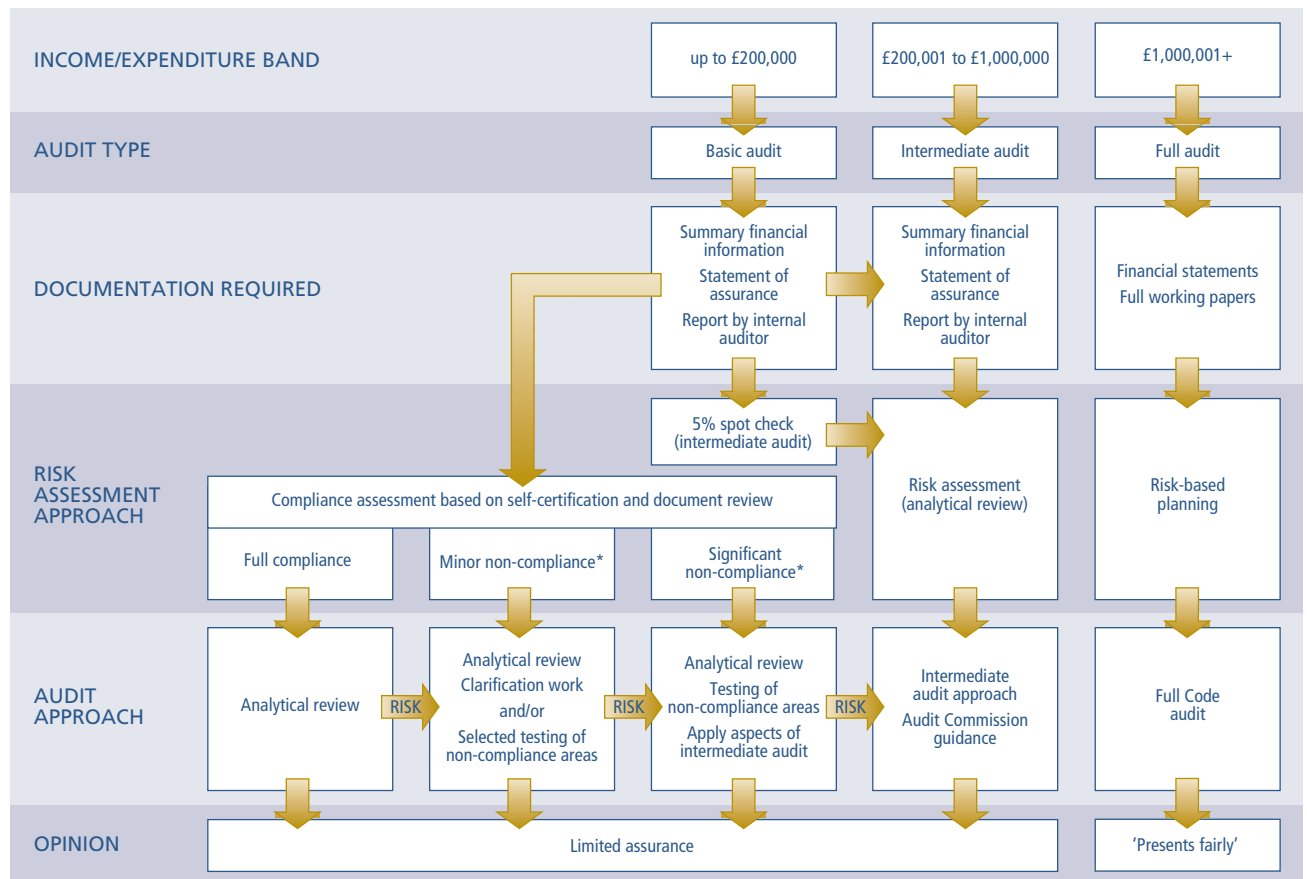
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## Appendix 3 The approach to the audit of Internal Drainage Boards in England and Wales

The new external audit approach distinguishes between three types of Internal Drainage Board:

- Boards with neither annual income or expenditure in excess of £200,000 (Group A);
- Boards with neither annual income nor expenditure exceeding £1,000,000 (Group B), and
- Boards operating above £1,000,000.

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



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

The framework will enable auditors to adopt a tailored audit approach.

Source: Audit Commission

Governance and Accountability in Internal Drainage Boards in England:  
A Practitioners' Guide 2006

## **Appendix 4**

# **Extracts from the Audit Commission's Code of Audit Practice**

[Click here](#) for an accessible version on the Audit Commission's website

# Schedule 1: The audit of small bodies

## Introduction

- s1.1 It is inappropriate to apply the same level of audit scrutiny to certain bodies as to principal authorities, because of the relatively small amounts of public money controlled by the bodies in question. This Schedule sets out the approach to be adopted for the audit of small bodies with either annual income, or annual expenditure, of up to a financial level determined, after consultation with relevant bodies, from time to time by the Commission (referred to in this Schedule as small bodies).

## Governance and accountability

- s1.2 It is the responsibility of small bodies to put in place proper arrangements to ensure the proper conduct of their financial affairs, and to monitor the adequacy and effectiveness of those arrangements in practice. Small bodies are required to prepare their accounts in accordance with their statutory responsibilities, and to maintain an adequate system of internal audit of their accounting records and control systems.
- s1.3 Small bodies meet their responsibilities by preparing and publishing, and providing the auditor with, the accounts prepared for the financial year, together with such additional information and explanation as is necessary to provide sufficient evidence that they have maintained adequate systems of internal control and internal audit throughout the financial year.

## The audit approach

- s1.4 Auditors of small bodies should undertake an examination of the annual accounts and additional information and explanation provided by the body.
- s1.5 Auditors should meet their responsibility by:
- reviewing compliance with the requirements for the preparation of the annual accounts;

- carrying out a high-level analytical review of financial and other information provided to the auditor; and
  - reviewing such additional information and explanation as is necessary to provide sufficient evidence that the body has maintained an adequate system of internal control and internal audit throughout the financial year.
- S1.6** Where, on the basis of the auditor's review, the auditor requires further evidence in relation to any relevant matter, additional testing should be undertaken to address the auditor's concerns.
- S1.7** When the auditor has completed an examination of the annual accounts and additional information and explanation provided, the auditor gives an opinion on the accounts and certifies the completion of the audit. Auditors provide assurance in the form of an opinion whether, on the basis of their review, the accounts and the other information provided are in accordance with the specified requirements and that no matters have come to their attention giving cause for concern that relevant legislative and regulatory requirements have not been met.

## Appendix 5 - Audit Commission's Supplementary Guidance to Limited Assurance Auditors

### Audit Commission's Supplementary Guidance for Local Council Auditors

## Guidance issued by the Audit Commission to Local Council External Auditors on the overall scope and approach of their audit

### GENERAL PRINCIPLES – SCOPE OF THE CODE (see *Code of Audit Practice* paragraph 4)

- 1 Most local council audits will be carried out under Schedule 3, as referred to at paragraph 4 of the Code. **Auditors will be expected to apply the 'lighter touch' audit approach summarised in schedule 3 of the Code where councils qualify for this.** For the purposes of this document, reference to the 'full Code' audit is to be taken to mean an audit carried out in accordance with the full *Code of Audit Practice*, excluding Schedule 3.
- 2 Auditors of local councils with annual income, or annual expenditure, of £500,000 or above, will need to consider how to carry out the audit in accordance with those aspects of the Code which apply to such bodies. Paragraph 4 of the Code, from which the above extract is taken, also states that 'Auditors of other small bodies ... should apply the Code in so far as, in their judgment, it is appropriate, taking into account any relevant guidance issued by the Commission'. The relevant guidance is set out in the following paragraphs of this section of the guidance.
- 3 **When a local council has annual income, or annual expenditure, of £500,000 or above, the appointed auditor will make enquiries as to whether this is the result of a one-off event which, for one year only, will lift the council above the threshold or whether this reflects a level of income or expenditure which is normal, or becoming normal, for the council.** In making such enquiries the auditor will have regard to the need for local councils to comply with the local government SORP when their annual income or expenditure has been at least £500,000 for three years in a row. **For local councils which are required to follow the SORP the auditor will be expected to carry out an audit leading to a 'presents fairly' opinion and the auditor will be expected to comply,**

on the basis of their documented risk assessment, with relevant aspects of the full Code.

- 4 **For those local councils where the auditor is satisfied that annual income or expenditure over £500,000 is normal, or is becoming normal as a result of continuing at this level over the next two or three years, the auditor will be expected to carry out an audit leading to a ‘presents fairly’ opinion and the auditor will be expected to comply, on the basis of their documented risk assessment, with relevant aspects of the full Code.**
- 5 **In any circumstances when it is appropriate for the auditor to comply with the full Code, he or she is expected to ‘consider and assess the relevant significant operational and financial risks that apply to the audited body and the arrangements it has in place to manage these risks. The aim of this exercise is to prepare an audit plan that properly tailors the nature and conduct of the audit work to the circumstances of the audited body, so that effort is directed to those areas of greatest risk’ (paragraph 20 of the Code).**
- 6 When annual income or expenditure over £500,000 is the result of a one-off event which, for one year only, has taken the council above the threshold, auditors will be expected to apply the Code in a way which is proportionate to the risks, needs and circumstances which they find. In such circumstances the local council will, in the following year, fall back below the £500,000 threshold and the Commission’s guidance to the auditor is that carrying out an audit under schedule 3 would be the most appropriate way of applying the Code. **In so doing the auditor will be expected to apply and document a risk based approach and, as stated at paragraph S3.6 of Schedule 3, where he or she determines that ‘further evidence in relation to any relevant matter’ is required, ‘additional testing should be undertaken to address the auditor’s concerns.’ A relevant matter would include the event, and related transactions, which has taken the council over the £500,000 threshold.** For the avoidance of doubt, this approach will – subject to the results of the audit – be intended to lead to a limited assurance audit report.

## **Audit Model**

### *Overview*

- 7 The model of delivery for the external audit of local councils, as approved by the Commission, is shown in the flowchart at Appendix 2.
- 8 The key elements of the model are:
  - all local councils in England and Wales are required to complete an annual return (see Appendix 5 of *Governance and Accountability in*



*Local Councils in England and Wales – A Practitioners’ Guide* for a copy of the proforma);

- the smallest local councils and parish meetings who have no financial activity may opt for the short-form annual return which serves as a ‘nil return’;
- local councils with a turnover (i.e. the greater of budgeted or actual annual income or annual expenditure) up to £100,000 will be entitled to a "basic" audit;
- councils with an annual turnover between £100,001 and £500,000 will be entitled to an "intermediate" audit;
- local councils with an annual turnover greater than £500,000 or which are statutory best value councils fall outside the scope of these arrangements and will continue to receive a "full" audit as under present arrangements, i.e. leading to a ‘presents fairly’ opinion. Councils with a regular turnover that is approaching the £500,000 mark may wish to opt for a "full" audit in anticipation of their future transition into this group;
- the new approach comprises three key elements:
  - a compliance test against the requirements of the annual return;
  - a high level analytical review of the financial and other information provided to the auditor; and
  - a review of the statement of assurance given by the council and its supporting report from the council’s appointed internal auditor;
- this work leads to the issue, by the external auditor, of a limited assurance opinion on the annual return and a certificate of closure;
- at no extra cost to individual councils selected, all local councils will be subject to a 5% selection for more detailed audit – the ‘spot check’; and
- the model envisages that wherever the auditor is, for any reason, unable to progress directly to giving an opinion on the annual return, based on the information submitted for audit, enquiry and/or further audit work should be targeted at the specific omission, error or risk area. The reasons should be appropriately documented, and the council informed of the intention to carry out the work and the likely cost implications. In the spirit of the ‘lighter touch’ any further audit testing should be designed to deal with the specific issues identified and auditors, who are subject to the Commission’s quality review process, should ensure that they avoid over-auditing.

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

10 **All audits (regardless of the size of the local council) must still be ‘called’ by the auditor.** This process is a legal requirement designed to ensure that certain rights of electors can be exercised. Under this process the auditor appoints a date, on or after which electors’ rights may be exercised, by notifying the relevant local council. Each appointed auditor will need to make their own administrative arrangements for meeting this requirement, but may wish to use the Commission’s AF3 form which is

designed for this purpose. Each local council is responsible for properly publicising this information. Electors' rights are a sensitive area and so the auditor will wish to be satisfied that the council has provided an assurance that this has been done.

### *Basic audit*

- 11 **The auditor will carry out these procedures for all local councils falling below the £500,000 threshold (subject to the requirements of paragraphs 1 to 6 above).** Where the council has a *turnover of less than £100,000 per annum*, and is not chosen as part of the quality assurance sample, then these procedures will – if properly applied – enable the completion of the limited assurance audit. Where the council has a greater turnover, or is part of the quality assurance sample, the 'intermediate audit' procedures described below will also have to be followed.
- 12 The council will complete and submit the annual return proforma. Three sections should be completed:
- *Section 1: Statement of accounts* – The council should have transferred key financial data items from the local council's accounting records in accordance with the guidance provided on the proforma;
  - *Section 2: Statement of assurance* – This should be completed by the members of the council summarising their acceptance and understanding of their statutory responsibilities and providing an acknowledgement that they have fulfilled the duties imposed by statute (as per the proforma); and
  - *Section 4: Annual report by the internal auditor* – This should contain a report on the adequacy and effectiveness of the council's system of internal controls as per the proforma;
- 13 Guidance in the annual return proforma reminds councils to attach certain other documentation. This will be the minimum required and failure to provide this will trigger additional audit input, which may be charged to the local council. The further information to be submitted to the external auditor with the annual return is:
- year-end bank reconciliations. An example of the suggested format is given in *Governance and Accountability in Local Councils in England and Wales – A Practitioners' Guide* after paragraph 126. Copies of bank statement pages covering the 31 March may be attached; and
  - brief explanation(s) of significant variations from last year to this year in the annual return.
- 14 Auditors may also wish to obtain certain optional additional information, as follows:

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

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

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

*Intermediate Audit (councils with turnover between £100,000 and £500,000)*

**– In addition to the requirements of the basic audit above, auditors should plan and carry out work in order to complete the Audit Commission's intermediate audit guidance. This focuses on the council's overall control environment and helps the auditor to plan any further work indicated by the results.** The guidance is as follows:

*The 'Intermediate audit' framework – guidance for auditors*

16 The intermediate audit is the process whereby auditors obtain additional audit evidence in support of their opinion to reflect the additional audit risk associated with higher levels of activity or expenditure at larger local councils, as defined below, or in support of the 5% spot checks of 'basic' audits.

- 17 In addition to the basic audit, auditors may wish to apply general and specific audit tests designed to give them greater assurance about the audited body's risk management and corporate governance arrangements than can be provided by the annual return alone. It is applicable to all local councils where either their annual expenditure or annual income *exceeds £100,000 but is below £500,000*. It is also applicable to an annual sample of 5% of local councils with a turnover of under £100,000 per annum. This sample is used to establish the ongoing efficacy of the basic audit approach.
- 18 Councils with annual income or annual expenditure in excess of £500,000 are subject to a 'full' audit and thus fall outside the scope of this framework (see paragraphs 1 to 6 above).
- 19 The intermediate audit seeks to test one or more of the assertions made by the audited body and thereby provide additional audit evidence through a 'show me' approach to the responses given in the statement of assurance. **The auditor will consider the following factors in order to determine the frequency and extent to which they wish to apply some or all of the suggested tests:**
- the initial risk assessment;
  - cumulative audit knowledge and experience;
  - the outcome of the analytical review of information supplied; and
  - the level of compliance with requirements,
- 20 Auditors may, in addition, develop bespoke testing to address specific audit risks identified that are not covered elsewhere and determine the appropriate cycle for basic tests.
- 21 **The Commission expects the evidence required by auditors for intermediate audit to be proportionate to the audit risk. Any additional work arising from intermediate audit must be evidenced and documented in accordance with audit suppliers' policies and procedures having regard to Statements of Auditing Standards, as appropriate.**
- 22 Each of the eight assertions in the statement of assurance (Section 2 of the annual return) is reproduced below, together with some suggested tests that may be applied, either in the form of an additional questionnaire to the local council or by using other audit methods.
- 23 **In order to reduce the frequency of correspondence and to provide a reasonable time for response, the Commission recommends that in practice, auditors should, wherever possible, advise the audited body when calling the audit about the additional evidence being sought under intermediate audit.** A provision for this has been made in a standard audit form ('AF3').

- 24 The cost of intermediate audit, whether for group B councils or for the 5% sample of smaller councils, is included in the turnover related scale fees.
- 25 **Auditors should always bear in mind when planning the intermediate audit that the format of the audit opinion is the same limited assurance opinion that applies to 'basic' audit.**

## VALIDATING THE ASSURANCES IN THE INTERMEDIATE AUDIT – AUDIT COMMISSION GUIDELINES

Statement of Assurance	Possible further assurance request	Possible additional documentation request
<ul style="list-style-type: none"> <li>“we have approved the accounts which have been prepared in accordance with the requirements of the Accounts and Audit Regulations 1996 and proper accounting practice”</li> </ul>	<p>Does the council have access to the Practitioners’ Guide on proper practices and has prepared the accounts in accordance with this guidance?</p> <p>Has the council properly prepared its financial summary?</p> <p>Did the council/committee review the bank reconciliation?</p>	<p>Copy of financial statements on which annual return is based</p> <p>Copy of extended trial balance (if I &amp; E)</p> <p>Copy of closing bank statement(s)</p>
<ul style="list-style-type: none"> <li>“we have maintained an adequate system of internal control, including measures designed to prevent and detect fraud and corruption”</li> </ul>	<p>Confirm that arrangements in place to ensure system of internal control is fully documented</p> <p>Confirm that council receives regular reports regarding internal controls/fraud protection</p>	<p>Copy of internal auditor’s reports re internal controls</p> <p>Copy of minute(s) where internal controls discussed/approved</p>
<ul style="list-style-type: none"> <li>“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”</li> </ul>	<p>Confirmation that all expenditure decisions made are within existing powers which are minuted</p> <p>Confirm council has adopted Standing Orders and Financial Regulation</p> <p>Confirm council has adopted the Code of Conduct</p> <p>Confirm all members have signed acceptance of Code</p> <p>Confirm council has met all duties in regard to its role as charitable trustee (if any)</p>	<p>Copies of minutes for a selected period showing expenditure powers have been properly identified</p> <p>Copy of Standing Orders/Financial Regulations and/or minute adopting</p> <p>Copy of minute adopting Code of Conduct</p> <p>Sample copies of members’ acceptance of Code</p>

## VALIDATING THE ASSURANCES IN THE INTERMEDIATE AUDIT – AUDIT COMMISSION GUIDELINES

Statement of Assurance	Possible further assurance request	Possible additional documentation request
<ul style="list-style-type: none"> <li>“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”</li> </ul>	<p>Confirm that a detailed risk assessment has been carried out/updated and considered by the council</p> <p>Confirm that appropriate insurance cover for identified risk is in place</p> <p>Confirm council regularly seeks assurance regarding internal controls</p>	<p>Copy of risk assessment minute</p> <p>Copy of insurance schedule including value of Fidelity Guarantee bond</p> <p>Copy of any risk assessment reports</p>
<ul style="list-style-type: none"> <li>“we have appointed an internal auditor who is both competent and who has acted independently from influence by the council”</li> </ul>	<p>Confirm that internal auditor is a suitable person to carry out the work in accordance with proper practice guidance</p> <p>Confirm that internal auditor is not requested to undertake tasks which may compromise or fetter his/her independence</p>	<p>Copy of minute appointing/re-appointing internal auditor</p> <p>Copy of letter of engagement scoping IA work</p> <p>Copy of annual letter from IA confirming continuing independence</p>
<ul style="list-style-type: none"> <li>“we have taken what we consider to be appropriate action on all matters raised in previous reports from the internal and external auditors”</li> </ul>	<p>Confirm that all internal and external reports have been placed before and considered by the council</p> <p>Confirm that there are no outstanding matters from previous audit reports</p>	<p>Copy of minute recording auditors' reports</p> <p>Copy of agreed action plans to carry out recommendations</p>
<ul style="list-style-type: none"> <li>“we have provided proper opportunity for the exercise of electors' rights in accordance with the requirements of the Accounts and Audit Regulations 1996”</li> </ul>	<p>Confirm that notice of audit has been prominently displayed</p> <p>Confirm that notice of completion of audit has been properly displayed</p> <p>Confirm that accounts have been made available to electors</p>	<p>Copy of notice of audit</p> <p>Copy of notice of completion of audit</p> <p>Copy of arrangements in place for inspection of accounts</p>

Governance and Accountability in Internal Drainage Boards in England:  
A Practitioners' Guide 2006

## **Appendix 6**

### **Annual return for Internal Drainage Boards for the year ending 31 March 2006**



# Internal Drainage Boards in England

## Annual return for the year ended

### 31 March 2006

Internal Drainage Boards in England with an annual turnover of £1 million or less must complete a return summarising their annual activities at the completion of each financial year.

The annual return on the following pages is made up of four sections. Sections 1 to 3 represent the Board's statutory financial statements. Sections 1 and 2 are to be completed by the person nominated by the Board and Section 4 by the Board's internal audit. Section 3 will be completed by the external auditor.

**Please complete all relevant sections, which are highlighted in light blue for your convenience. Do not leave any light blue box blank.** Incomplete or incorrect returns may require additional external audit work, which will be charged at the Commission's agreed variable fee rate.

When Sections 1 and 2 have been approved by the board and section 4 is complete, please send the annual return, together with any additional information requested, to your appointed external auditor who will add the certificate and opinion in section 3.

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

Please complete this checklist		
Content	Key step	Done?
<b>Section 1</b> Statement of Accounts	All light blue boxes have been completed?	
	Board approval confirmed by signature of Chair of meeting approving accounts?	
<b>Section 1</b> Information requested in support	An explanation of significant variations from last year to this year is provided?	
	Bank reconciliation as at 31 March 2006 agreed to Box 8? An explanation for any difference between Box 7 and Box 8 is provided?	
<b>Section 2</b> Statement of Assurance	All light blue boxes have been completed?	
<b>Section 2</b> Explanation of 'no' responses	For any statement to which the response is 'no', an explanation is provided?	
<b>Section 4</b> Internal Audit's report	All light blue boxes completed by internal audit and explanations provided?	
<b>All sections</b> Completed return and requested supporting information	All information requested by the external auditor has been sent with this annual return? Please refer to your notice of audit.	

Audited and certified annual returns will be returned to the Board for publication in accordance with the Accounts and Audit Regulations and for submission to Defra with the annual report. There is no requirement for Boards to publish internal audit's annual report although Boards may choose to do so.

Guidance notes and instructions for completion are included at relevant points in the annual return. In the event that further guidance may be required, boards may refer to the draft ADA practitioners' guide (*Governance and Accountability in Internal Drainage Boards in England*). It should not be necessary for boards to contact Defra, the external auditor or the Audit Commission direct for guidance.

Internal Drainage Boards in England

# Annual return

for the year ended 31 March 2006

Internal Drainage Board

## Section 1 – The statement of accounts

In completing the boxes below please explain any significant variances on a separate sheet and send this to the external auditor together with a copy of your bank reconciliation as at 31 March 2006.

	Year ending		Notes and Guidance for Compilers
	31 March 2005 £	31 March 2006 £	
			<b>Please round all figures to nearest £. Do not leave any boxes blank and report £0 or Nil balances. All figures must agree to the board's underlying financial records for the relevant year.</b>
1 Balances brought forward			Total balances and reserves at the beginning of the year as recorded in the Board's financial records.
2 (+) Rates and special levies			Total amount of income received in the year from direct rates on landowners and special levies on local authorities.
3 (+) All other income			Total income or receipts as recorded in the cashbook minus the rates and special levies. Include all EA contributions here.
4 (-) Watercourses and pumping stations			Total expenditure including capital spending on construction and maintenance of watercourses and pumping stations.
5 (-) Loan interest/ capital repayments			Total expenditure or payments of capital and interest made during the year on the board's borrowings (if any).
6 (-) All other expenditure			Total expenditure or payments as recorded in the cashbook minus watercourses and pumping stations (line 4) and loan interest/capital repayments (line 5). Include all contributions to EA here.
7 (=) Balances carried forward			Total balances and reserves at the end of the year. (Must equal $(1+2+3) - (4+5+6)$ )
8 Total cash & investments			The sum of all current and deposit bank accounts, cash holdings and investments held as at 31 March – to agree with bank reconciliation.
9 Total fixed assets and long term assets			The recorded current book value at 31 March of all fixed assets owned by the Board and any other long term assets e.g. loans to third parties.
10 Total borrowings			The outstanding capital balance as at 31 March of all loans from third parties (including PWLB).

I certify that the statement of accounts contained in this annual return presents fairly the financial position of the board and its income and expenditure, or properly presents receipts and payments, as the case may be, for the year ended 31 March 2006.

Signed by Responsible Financial Officer:

Date

I confirm that these accounts were approved by the board and recorded as Board minute

reference:

Date

Signed by Chair of meeting approving Board's accounts:

Date

## Section 2 – Statement of assurance

We acknowledge as the members of  our responsibility for ensuring that there is a sound system of internal control, including the preparation of the statement of accounts, and confirm, to the best of our knowledge and belief, with respect to the Board's statement of accounts for the year ended 31 March 2006, that:

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

This Statement of Assurance is approved by the board and recorded as board minute reference

dated

Signed on behalf of

Signed by: Chair  Date

Signed by: Clerk  Date

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

## Section 3 – External auditor’s certificate and opinion

### Certificate

We certify that we have completed the audit of the annual return of   
 Internal Drainage Board for the year ended 31 March 2006.

### Respective responsibilities of the board and the auditor

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

- summarises the board’s accounting records for the year ended 31 March 2006; and
- confirms and provides assurance on those matters that are important to our audit responsibilities.

Our responsibility is to conduct an audit in accordance with guidance issued by the Audit Commission and, on the basis of our review of the annual return and supporting information, to report whether any matters that come to our attention give cause for concern that relevant legislation and regulatory requirements have not been met.

### External Auditor’s report

(Except for the matters reported below)\* on the basis of our review, in our opinion the information contained in the annual return is in accordance with the Audit Commission’s requirements and no matters have come to our attention giving cause for concern that relevant legislation and regulatory requirements have not been met. (\*delete as appropriate).

(continue on a separate sheet if required)

Other matters not affecting our opinion which we wish to draw to the attention of the Board:

(continue on a separate sheet if required)

External Auditor’s signature

External Auditor’s name  Date

**Note:** The auditor signing this page has been appointed by the Audit Commission and is reporting to you that they have carried out and completed all the work that is required of them by law. For further information please refer to the Audit Commission’s publication entitled *Statement of Responsibilities of Auditors and of Audited Bodies*.

## Section 4 – Annual internal audit report to:

Internal Drainage Board

The board's internal audit, acting independently and on the basis of an assessment of risk, has included carrying out a selective assessment of compliance with relevant procedures and controls expected to be in operation during the financial year ended 31 March 2006.

The internal audit has been carried out in accordance with the board's needs and planned coverage. On the basis of the findings in the areas examined, the internal audit conclusions are summarised in this table. Set out below are the objectives of internal control and, opposite, are the internal audit conclusions on whether, in all significant respects, the following objectives were being achieved throughout the financial year to a standard adequate to meet the needs of the board.

	Agreed? Please choose from one of the following Yes/No*/Not covered**
A Appropriate books of account have been properly kept throughout the year.	
B The board's financial regulations have been met, payments were supported by invoices, expenditure was approved and VAT was appropriately accounted for.	
C The board assessed the significant risks to achieving its objectives and had adequate arrangements to manage these.	
D The annual rating requirement resulted from an adequate budgetary process; progress against the budget was regularly monitored; and reserves were appropriate.	
E Expected income was fully received, based on correct prices, properly recorded and promptly banked; and VAT was appropriately accounted for.	
F Petty cash payments were properly supported by receipts, expenditure was approved and VAT appropriately accounted for.	
G Salaries to employees and allowances to members were paid in accordance with Board approvals, and PAYE and NI requirements were properly applied.	
H Asset and investments registers were complete and accurate and properly maintained.	
I Periodic and year-end bank account reconciliations were properly carried out.	
J Year end accounts were prepared on the correct accounting basis (receipts & payments/income & expenditure), agreed with cash book, were supported by an adequate audit trail from underlying records, and, where appropriate debtors and creditors were properly recorded.	

For any other risk areas identified by the board (list any other risk areas below or on separate sheets if needed) adequate controls existed:


Name of person who carried out the internal audit:

Signature of person who carried out the internal audit:

Date:

\* If the response is 'no' please state the implications and action being taken to address any weakness in control identified (add separate sheets if needed).

\*\* If the response is 'not covered' please state when the most recent internal audit work was done in this area and when it is next planned, or, if coverage is not required, internal audit must explain why not (add separate sheets if needed).

## Section 5 – Guidance notes on completing the 2006 annual return

- 1 Please make sure that your annual return is complete (i.e. no empty blue boxes), properly signed and dated. Avoid making any amendments to the completed return. But, if this is unavoidable, make sure the amendments are approved by the drainage board, properly initialled and an explanation for them is provided to the auditor. Annual returns containing unapproved and/or unexplained amendments will be returned unaudited.
- 2 Use the checklist provided on page 1. Use a second pair of eyes, perhaps internal audit or the Chair just before he or she signs it, to review your annual return for completeness before sending it off to the auditor.
- 3 Make sure that the copy of the bank reconciliation which you send to your auditor with the annual return covers **all** your bank accounts. If your drainage board holds any investments, please note their value on the bank reconciliation. The auditor should be able to agree your bank reconciliation to Box 8 on the Statement of Accounts. **You must provide an explanation for any difference between Box 7 and Box 8.** More help on bank reconciliations is available in the draft *Practitioners' Guide*\*.
- 4 Please **explain fully** significant variances in the statement of accounts. Do not just send in a copy of your detailed accounts instead of this explanation. The auditor wants to know that **you** understand the reasons for the change. Please include a relevant analysis to support your explanation. There are a number of examples provided in the draft *Practitioners' Guide*\* to assist you.
- 5 Please do not send the auditor any information that you are not specifically asked for. Doing so is not helpful. If the auditor has to review unsolicited information, this will take additional time and may incur additional cost for which the auditor is entitled to charge.
- 6 Please make sure that your statement of accounts adds up! Also please ensure that the balance carried forward from the previous year (Box 7 of 2005) equals the balance brought forward in the current year (Box 1 of 2006).
- 7 **Do not complete section 3.** This section is reserved for the external auditor who will complete it at the conclusion of their audit.
- 8 You may use the draft *Practitioners' Guide*\* for further help. The aim is for this publication to be made available on the ADA's website and for it to be regularly updated. You may wish to contact ADA at the address below should you wish to talk through any problem you may encounter with the guide.

\* *Governance and Accountability for Internal Drainage Boards in England – A Practitioners' Guide*, is available in draft on the ADA website [www.ada.org.uk](http://www.ada.org.uk) or from the ADA at The Association of Drainage Authorities, 12 Cranes Drive, Surbiton, Surrey, KT5 8AL.

## **Appendix 7**

# **Accounts and Audit Regulations and Guidance**

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

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

**CLG Guidance Circular 03/2006**

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