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# Appendix 5 – Standing Guidance issued by the Audit Commission to External Auditors to small bodies on the overall scope and approach of their audit

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## **Small Bodies – the Limited Assurance audit approach (SG Appendix 25)**

### **(Schedule 1 of the Code of Audit Practice (LG))**

- 1 Auditors must recognise the fundamental difference between carrying out an audit with a view to giving a 'presents fairly' opinion, and carrying out an audit of a small body with a view to giving limited assurance in an opinion based on limited procedures. They should plan their work accordingly, adopting a risk based approach.
- 2 The Commission works closely with the National Association of Local Councils (NALC) and the Society of Local Council Clerks (SLCC) and their County Associations. Similarly, in relation to Internal Drainage Boards, the Commission has developed a technical matters relationship with the Association of Drainage Authorities (ADA). The Commission supports NALC's, SLCC's and the ADA's technical advisory networks. These networks, rather than the external auditors, should be the first point of contact for small bodies with technical accounting queries or questions about the new audit framework. The Commission will provide technical support to the representative body networks as well as to auditors. In view of this, if asked to provide technical assistance, auditors should remind small bodies and their officers of these arrangements and that they are entitled to charge for time taken in resolving enquiries which are outside the audit engagement.

## Model of delivery

### Overview

- 3 The model of delivery approved by the Commission is shown in the flowchart at Appendix 2 of both Governance and Accountability in Local Councils – A Practitioners' Guide (England) 2010 published jointly by NALC and SLCC and Governance and Accountability for Internal Drainage Boards – A Practitioners' Guide (England) 2010 published by ADA.
- 4 The key elements of the model are as follows.
  - All small bodies in England are required to complete an annual return (see Appendix 5 of the Practitioners' Guide for the pro forma return).
  - Some small bodies, such as parish meetings, which have no financial activity, may be eligible for the short-form annual return which serves as a 'nil return'.
  - Small bodies with an annual turnover (ie the greater of gross income or gross expenditure) up to £200,000 will be entitled to a 'basic' audit.
  - Bodies with an annual turnover between £200,001 and £1 million are entitled to an 'intermediate' audit.
  - Small bodies with an annual turnover greater than £1 million fall outside the scope of these arrangements and will receive a full Code audit ie leading to a 'true and fair opinion. Bodies with a regular turnover that is approaching £1 million may wish to opt for a 'full' audit in anticipation of their future transition into this group.
  - The 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 bodies selected, all annual returns are subject to a 5 per cent quality assurance sample for more detailed audit – the 'spot check'.
  - Wherever the auditor is, for any reason, unable to progress directly to giving an opinion on the annual return based on the information submitted by the body, further enquiry or audit work should be targeted at the specific omission, error or risk area. The auditor must inform the council of the reasons for additional work, which must be appropriately documented, and the likely cost implications before commencement. Any further audit testing should be designed to deal with the specific issues identified and auditors must avoid over-auditing.

- 5 The Commission has established the overall framework within which auditors will operate. But as with any audit engagement, appointed auditors exercise professional judgement on how best to carry out the work required in support of the limited assurance opinion on the annual returns.
- 6 All audits (regardless of the size of the body) must still be 'called' by the auditor. This process is a legal requirement designed to ensure the statutory rights of electors can be exercised. The auditor appoints a date on or after which electors' rights may be exercised by notifying the relevant small body. 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 small body is responsible for properly publicising this information. Electors' rights are a sensitive area and the auditor will wish to be satisfied that the body has provided assurance that this has been done.

### **Basic audit**

- 7 The auditor must carry out these procedures for all small bodies falling below the £1 million threshold. Where the body has a turnover of less than £200,000 per annum, and is not selected to be part of the 5 per cent 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 additional 'intermediate' audit procedures described below must also be followed.
- 8 The council will complete and submit the annual return pro forma. Three sections should be completed.
  - Section 1: Accounting statements – the body should have transferred key financial data items from its prime accounting records in accordance with the guidance provided on the pro forma.
  - Section 2: Annual Governance Statement – this should be completed by the members of the body meeting as a council. The statement summarises their acceptance and understanding of their statutory responsibilities and provides an acknowledgement that they have fulfilled the duties imposed by statute.
  - Section 4: Annual report by internal audit – independent reporting on the adequacy and effectiveness of the body's system of internal controls.
- 9 Guidance in the annual return reminds bodies to attach certain other documentation. This is the minimum required. Failure to provide this will trigger additional audit input, which may be charged to the small body in addition to the standard fee. The minimum information to be submitted to the external auditor with the annual return is as follows.
  - Year-end bank reconciliation. An example of the suggested format is given in the Practitioners' Guides. Copies of bank statement pages covering the 31 March financial year-end may also be attached.
  - Brief explanation(s) of significant variances in the annual return.

**10** Auditors may obtain additional information.

- If audit procedures (analytical review, risk assessment, cumulative audit knowledge etc) or the body's unresolved omission or error on the annual return, or some other justifiable reason, indicate possible irregularity, the auditor may, having informed the body of their intention, request an independent verification of bank and/or investment balances. Auditors should note that there is a cost implication for small bodies in making such a request. Banks may charge for this service.
- The Commission will make available to auditors year-end balances of borrowings by small bodies from the Public Works Loan Board ('PWLB').
- Auditors should make their own arrangements with principal authorities in their contract area (or through their auditors) to receive local council precept data for the relevant financial year.

**11** 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 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, make an estimate of the time required to carry out this work and inform the audited body of the likely cost before commencing the work. The justification for the decision to carry out any additional work must be properly evidenced and documented.
- If the additional work can be avoided by the small body providing further information to the auditor, the body should be given the opportunity to comply before additional work is undertaken.

**Intermediate audit (bodies with annual turnover between £200,000 and £1 million)**

**12** 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 expenditure at small bodies or in support of the 5 per cent spot check of basic audits.

**13** In addition to the basic audit, auditors should apply 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 small bodies where either the annual expenditure or annual income exceeds £200,000 but is below £1 million. It is also applicable to an annual sample of 5 per cent of small bodies with a turnover of under £200,000 per annum. This sample is used to provide quality assurance.

- 14** The intermediate audit seeks to test one or more of the assertions made by the audited body in the annual governance statement. Bodies must provide additional audit evidence through a 'show me' approach to the responses given in the annual governance statement. 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; and
  - cumulative audit knowledge and experience.
- 15** In addition, the auditor may also consider the following factors, when information is received from the small body:
- the outcome of analytical review of information supplied; and
  - the level of compliance with requirements.
- 16** The auditor will only consider making a further document request if the necessary information cannot be obtained from the documents already obtained from the small body.
- 17** The Commission expects the evidence required by auditors for intermediate audit to be proportionate to audit risk. Auditors may plan a cyclical approach to the audit of the statement of assurance based on risk in order to minimise additional information required annually. Any additional work arising from intermediate audit must be evidenced and documented as appropriate.
- 18** Each of the nine assertions in the statement of assurance (Section 2 of the annual return) is reproduced in the table below, together with some suggested tests that may be applied, either in the form of further enquiries to the smaller body or by using other audit methods.
- 19** In order to reduce the frequency of correspondence and to provide a reasonable time for response, the Commission recommends that auditors advise the audited body when calling the audit about the additional evidence they require from bodies undergoing intermediate audit. Provision for this is made in the AF3.
- 20** The cost of intermediate audit, whether determined by the turnover of the small body or required for the 5 per cent sample of small bodies, is included in the scale fees.
- 21** Auditors should note when planning the intermediate audit that the audit opinion is the same limited assurance opinion that applies to basic audit.

## **Other matters**

### **Previous years' audits not completed**

- 22** In cases where the previous years' audits have not been completed/closed, for example if challenge matters are still outstanding, auditors should include the following text in their report on the return: 'The audit of the [small body]'s annual return for the years ended 31 March 20XX and 20YY is yet to be concluded. Consequently the audit for the year ended 31 March 20ZZ must remain open. While the audit report given above is in advance of the conclusion of the audit, we confirm that our opinion is subject only to any changes that may be required to balances brought forward as a consequence of the conclusion of prior years' audits.'

### **Audits uncompleted at statutory deadline**

- 23** In the event that an audit has not been concluded and no audit opinion has been issued by 30 September, the Accounts and Audit Regulations stipulate that the small body should publish its annual return together with a declaration and explanation of the fact that no audit opinion has been issued by the statutory publication date. In this event, auditors should provide affected bodies with a 'confirmation' letter suitable for public display confirming that as 'at the statutory publication date of 30 September 20XX no audit opinion has been issued in relation to the annual return for the year ended 31 March 20XX.'
- 24** A covering letter to the small body should set out the requirements of regulation 12 of the Accounts and Audit Regulations 2003 and should indicate that the small body can meet its statutory obligations by displaying a copy of the annual return marked 'subject to audit' at the top of section 1 alongside the 'confirmation' letter that the audit opinion has not been issued. The covering letter may also indicate that the requirement to publish can be achieved by display of the items on the same notice board(s) or in the same publication used for the notice of audit. Publication in a newspaper is not required unless that is the small body's usual or preferred method of advertising the audit.

Statement of Assurance	Possible further assurance request	Possible additional documentation request
<ul style="list-style-type: none"> <li>‘we have approved the accounting statements which have been prepared in accordance with the requirements of the Accounts and Audit Regulations and proper practices’</li> </ul>	<p>Does the small body have access to a Practitioners’ Guide on proper practices and have the accounting statements been prepared in accordance with this guidance?</p> <p>Has the body properly prepared its financial summary?</p> <p>Did the body/committee review the bank reconciliation?</p>	<p>Copy of accounting statements on which annual return is based</p> <p>Copy of extended trial balance (if I&amp;E)</p> <p>Copy of closing bank statements</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 and reviewed its effectiveness’</li> </ul>	<p>Confirm that arrangements in place to ensure system of internal control are fully documented</p> <p>Confirm that the body 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 small body to conduct its business or on its finances’</li> </ul>	<p>Confirmation that all expenditure decisions made are within existing powers and minuted</p> <p>Confirm body has adopted Standing Orders and Financial Regulations</p> <p>Confirm small body has adopted and applies the Code of Conduct, if applicable</p> <p>Confirm all members have received training on the Code of Conduct, if applicable</p> <p>Confirm small body has met all its 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>Extract from declarations of interest</p> <p>Sample copies of members’ acceptance of office</p>

Statement of Assurance	Possible further assurance request	Possible additional documentation request
<ul style="list-style-type: none"> <li>'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'</li> </ul>	Confirm that the notice of audit has been prominently advertised/displayed Confirm that the notice of completion of the audit has been properly advertised/displayed Confirm that accounts have been made available to electors	Copy of notice of audit  Copy of notice of completion of audit  Copy of arrangements in place for inspection of accounts
<ul style="list-style-type: none"> <li>'we have carried out an assessment of the risks facing the small body and taken appropriate steps to manage those risks, including the introduction of internal controls and/or external insurance cover where required'</li> </ul>	Confirm arrangements for risk management and how this has been carried out/updated and/or considered by the small body Confirm that appropriate insurance cover for identified risks is in place Confirm small body regularly seeks assurance regarding internal controls	Copy of risk management minute  Copy of insurance schedule including value of Fidelity Guarantee bond Copy of any risk assessment documentation or reports (if any)
<ul style="list-style-type: none"> <li>'we have maintained throughout the year an adequate and effective system of internal audit of the small body's accounting records and control systems and carried out a review of its effectiveness'</li> </ul>	Confirm that internal audit is carried out in accordance with proper practice guidance in the Practitioners' Guide Confirm that internal audit is not requested to undertake tasks or give advice which may compromise or fetter their independence or invalidate insurance cover	Copy of minute appointing/reappointing internal audit  Copy of letter of engagement scoping IA work Copy of annual letter from IA confirming continuing independence Copy of annual review of Internal Audit by the body

Statement of Assurance	Possible further assurance request	Possible additional documentation request
<ul style="list-style-type: none"> <li>'we have taken appropriate action on all matters raised in reports from internal and external audit'</li> </ul>	<p>Confirm that all internal and external audit reports have been placed before and considered by the small body</p> <p>Confirm that there are no outstanding matters from previous audit reports</p>	<p>Copy of minute recording auditors' report</p> <p>Copy of agreed action plans to carry out recommendations</p>
<ul style="list-style-type: none"> <li>'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 body and, where appropriate have included them in the accounting statements'</li> </ul>	<p>Confirm that reserves are adequate and not excessive</p> <p>Confirm that where there are any claims against the small body, any uninsured portion has been provided for</p> <p>Confirm small body has not borrowed any money other than for financing capital schemes and for which borrowing approval has been obtained</p> <p>Confirm no changes to existing capital programmes</p>	<p>Copy of analysis of reserves identifying general fund and any earmarked reserves</p> <p>Details of any provisions made or added to in the year</p> <p>Copy of capital expenditure programme</p> <p>Details of any loans outstanding or applied for</p> <p>Details of any current or planned lottery bids</p>
<p>[For local councils only]</p> <ul style="list-style-type: none"> <li>'Trust funds (including charitable) – in our capacity as the sole managing trustee we have discharged our responsibility in relation to the accountability for the funds/assets, including financial reporting and, if required, independent examination or audit.'</li> </ul>	<p>Confirm trust accounts and reporting are complete and timely</p> <p>Confirm arrangements for separating council and trustee business.</p> <p>Confirm separation of trust finances from those of the local council.</p>	<p>Copy of annual return to charity commission</p> <p>Copy of trust deed</p> <p>Copy of minutes of (separate) trust meetings</p> <p>Copy of separate trust bank mandates and statements</p>