May 2002/26

Core funding/operations

Framework for accountability

This report is for information and guidance

This document sets out the HEFCE's requirements for internal and external audit arrangements in the higher education institutions it funds, and the framework in which they operate. The Code supersedes the 1998 version, with effect from August 2002. It describes minimum audit requirements, and those considered to be good practice. Model versions of key documents are included for institutions to use at their own discretion.

Updated 16 September 2002: paragraph 48, Annex A paragraph 1c, Annex B paragraph 3

HEFCE Audit Code of Practice

HIGHER EDUCATION FUNDING COUNCIL FOR ENGLAND

Foreword

Higher education institutions continue to face considerable change and increasing pressure on the management of resources, both financial and non-financial. The HE sector needs to strike a balance between autonomy and the proper use of public funds. This Code aims to help achieve that balance by clarifying the respective responsibilities of governing bodies, management and auditors. The Code has been updated to reflect changes to the Accounts Direction for the HE sector, the reduction in audit burden through the HEFCE Audit Service taking a more risk-based and focused approach to auditing institutions (following consultation with the sector), and a new definition of the professional standards for internal auditors.

The Code sets out the audit arrangements we will use, lays down a framework for audit within institutions, and gives guidance on good audit practice. In doing this, we fully recognise the autonomy of institutions. Accordingly, the Code stresses the need for liaison and co-operation, and seeks to minimise its mandatory requirements. A great deal of the Code is concerned with good practice guidance. Implementing good practice should be the aim of every institution, because it is in their own interests, and I endorse the view that the Code will help them to do so.

From now on the Code will be maintained as an electronic document. This will enable the Code to be adapted to the continually changing audit, accountability and risk management circumstances in HE. Any minor changes will need my approval having taken the advice of the HEFCE Audit Committee. Any changes to mandatory requirements will be the subject of sector consultation. Institutions and the audit community will be alerted to all changes. The Code will be subject to full consultative review in 2003-04.

Sir Howard Newby
Chief Executive

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HEFCE Audit Code of Practice

To	Heads of HEFCE-funded higher education institutions Heads of universities in Northern Ireland
Of interest to those responsible for:	Senior management, Finance, Governance
Reference	2002/26
Publication date	May 2002
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Executive summary

Purpose

1. This document sets out the Council's updated requirements for institutions' internal and external audit arrangements and gives the broad framework in which they should operate.

Key points

2. This Code updates the 1998 version (HEFCE 98/28) with effect from 1 August 2002. The Code will be subject to a full consultative review in 2003-04. The updated parts take into account:

- the reduction in audit burden following changes to the operation of the HEFCE Audit Service
- the new Accounts Direction for the sector (HEFCE Circular Letter 24/00), which requires internal control and risk management assurances to be contained within published financial statements from 2002-03, as recommended by the Combined Code on Corporate Governance (the Turnbull Report)
- revised professional standards for internal auditors, for example from HM Treasury.

3. The Code describes our minimum audit requirements and those that we consider to be good practice or worthy of consideration. No additional mandatory requirements are included within this updated version of the Code, although we have clarified that when institutions submit their audit committee annual report this should be supported by the annual report of the internal auditor.

4. Model versions of key documents are provided for institutions to use at their own discretion.

Action requested

5. This document is for information and guidance.

Introduction

6. The Financial Memorandum between the Council and the Department for Education and Skills (DfES) requires the Council to issue an Audit Code of Practice (the Code). This Code is the Council's view on how effective audit coverage can be achieved. It sets out the Council's minimum requirements for external and internal audit arrangements, and the broad framework in which they should operate. The Code also provides an overview of the roles and responsibilities of the HEFCE’s Audit Service (HEFCEAS). It is not intended to cover academic audit or the audit requirements of any other body.

7. There are a number of mandatory requirements which are conditions of funding under the Financial Memorandum between the Council and institutions. Within this Code 'must' and 'will' denote mandatory requirements, and 'should' denotes the Council's view of good practice. 'May' indicates ideas worthy of consideration. For ease of reference, the mandatory requirements are set out in Annex A. The Code also includes a number of 'model' documents. These are for guidance only and, with the good practices set out, should be used with discretion. They may need adaptation to meet local circumstances. Additional guidance is available from the HEFCEAS.

8. The Council will assess compliance with these requirements, having regard to the guidance on good practice, and all the audit arrangements that an institution has in place. In line with professional guidance (for example in the Standards for the Professional Practice of Internal Auditing as published by the Institute of Internal Auditors), the HEFCEAS will seek to satisfy itself about the adequacy of an institution’s audit arrangements at least once every five years. This assessment will be based on a professional peer review of providers’ practice against professional standards.

9. The Code is primarily for use by internal and external auditors, institutions' senior management, members of the governing body and audit committees. It should be read with the relevant publications of the Auditing Practices Board. More detailed advice on any aspect of the Code is available from the HEFCEAS. The Code is not intended to be a manual. Institutions should consider developing their own manuals to detail more fully their own procedures for audit-related matters.

10. From time to time the Code needs to be updated. This is such an occasion, where we are taking the opportunity to incorporate developments relevant to audit in the sector which have been the subject of separate consultation. The Council intends to review the operation of the Code fully in 2003-04, and will consult interested parties before making changes to the mandatory requirements. The HEFCEAS welcomes comments on the Code and its operation at any time.

11. The Council may also supplement the Code with occasional Audit Practice Notes (APNs) and circular letters, giving guidance on good practice in specific areas, such as severance payments to senior staff (Circular Letter 7/97). They will be developed in consultation with the representative bodies in higher education, and may be incorporated into any subsequent revision of the Code. An APN will be issued giving further guidance on the work needed to produce internal control and risk management statements that meet the requirements of the new Accounts Direction.

12. The rest of this Code deals with the separate elements of audit arrangements, and sets out guidance on general principles of audit, the HEFCEAS, audit committees, internal audit and external audit.

Elements of audit

13. In accordance with their Financial Memorandum with the Council, institutions must have adequate risk management and effective management control. However, other public bodies also have an interest in these control arrangements, including Parliament, the Department for Education and Skills (DfES) and, if applicable, the Learning and Skills Council (LSC), the Research Councils, the Department for Employment and Learning (DEL) in Northern Ireland, and the Teacher Training Agency (TTA).

14. Each of these bodies needs to make appropriate arrangements to safeguard its interest. Each has its own auditors but in practice there are only two groups engaged in regular audit investigation of an institution's systems and records – an institution's internal and external auditors. This is the same level of activity that is common in the private sector. Of the interested parties, the DfES, the HEFCE, the LSC, the DEL and the TTA seek to avoid duplication by relying on the work of the other auditors whenever possible.

Parliament

15. Parliament's interest is to see that public funds are properly applied and accounted for and used economically, effectively and efficiently by recipients. The Comptroller and Auditor General, head of the National Audit Office (NAO), is the auditor of the HEFCE. He has the right to inspect the accounts of any institution that receives HEFCE grants, and the right to carry out value for money investigations. The NAO is highly selective in its use of inspection rights: most of the financial audit work can be undertaken at the HEFCE, and value for money investigations normally involve only a sample of institutions at any one time.

Department for Education and Skills

16. Public funds are channelled through the DfES, and the DfES Accounting Officer is responsible and accountable to Parliament. The Accounting Officer must be satisfied that proper arrangements are being made to safeguard public funds. This is achieved by requiring the HEFCE to have an audit service and appropriate accounting systems. The work of the HEFCE and its audit service is examined by the DfES audit service. The DfES may observe the HEFCE audit service at work in institutions but it does not audit institutions itself.

HEFCE

17. The HEFCE's Chief Executive is Accounting Officer for the funds received from the DfES and is accountable to Parliament for them. The Accounting Officer must therefore be satisfied that institutions are making proper arrangements to ensure that public funds are being used for the purposes for which they were given, and are adequately safeguarded. To obtain that assurance, the HEFCEAS will periodically assess compliance with this Code and assess the internal management controls of institutions, relying on the work of internal and external audit where appropriate. Additional information on serious weaknesses, significant frauds and any major accounting breakdowns is also required to help satisfy the Accounting Officer's responsibilities.

18. The governing body of the institution is responsible for ensuring the proper use of public funds. Under the Financial Memorandum, the governing body is required to designate a principal officer, known as the designated officer (the holder of the principal office of the institution, as defined in the Financial Memorandum between the HEFCE and the institution*)*. He or she should satisfy the governing body in respect of the use of public funds, and may be required to appear before the Public Accounts Committee of the House of Commons, alongside the HEFCE's Chief Executive, on matters relating to the use of funds provided by the HEFCE. We would expect the designated officer to be the institution's vice-chancellor, principal or equivalent.

19. The designated officer must inform, without delay, the chairman of the institution's audit committee, the chairman of the institution's governing body and the HEFCE Accounting Officer of any serious weakness, significant fraud or major accounting breakdown. If a matter requiring report is discovered by external or internal auditors in the normal course of their work and the designated officer refuses to make a report, then the auditors must report directly to the chairman of the institution's audit committee, the chairman of the institution's governing body and the HEFCE Accounting Officer. This is to ensure that the institution has taken appropriate action. In addition, the HEFCEAS is able to provide advice to institutions on dealing with fraud and irregularity, particularly when notified at an early stage. Information obtained, suitably anonymised, may be disseminated throughout the sector by the HEFCEAS, thereby enabling institutions to protect their interests. This process should also reduce the need for visits to institutions by the HEFCEAS.

20. In this Code, a serious weakness includes one that has resulted in an attempted, suspected or actual significant fraud or irregularity. Significant fraud is usually where one or more of the following apply:

a. The sums of money involved are, or potentially are, in excess of £10,000.

b. The particulars of the fraud are novel, unusual or complex.

c. There is likely to be public interest because of the nature of the fraud or the people involved.

21. There may be circumstances that do not fit this definition. In these cases or any others, institutions can seek advice or clarification from the HEFCEAS. In view of the public interest, institutions should normally notify the police of all suspected or actual fraud. Where the police are not

notified, management should advise the audit committee of the reason. Institutions are also referred to the guidance on fraud issued by the HEFCEAS in 1999 (published on the web only as HEFCE 99/65).

Learning and Skills Council and the Teacher Training Agency

22. Some institutions receive funds from the LSC or the TTA, who therefore also have an interest in their management and accountability. To avoid unnecessary duplication, the LSC and TTA will rely on the audit framework set out in this Code. They will not be directly involved in auditing higher education institutions, except they may occasionally request specific audit work to be undertaken in accordance with their own funding conditions.

General principles for internal and external auditors

Duties

23. These general principles for auditors are intended to supplement, not replace, those issued by the recognised professional bodies. This is necessary because the audit of public funds is different from those in the commercial sector, since auditors are also concerned with the HEFCE's requirements.

Independence

24. Auditors should declare potential conflicts of interest to the audit committee. Auditors should avoid the following:

a. Official, professional and personal relationships which might cause the auditor to limit the extent or character of the audit.

b. Any responsibility for the executive management of the institution.

c. Any interest, financial or non-financial, direct or indirect, in the institution (other than the normal employee or contractor relationship, or the funding of any prize, scholarship or academic appointment).

Due professional care

25. In exercising due professional care auditors should:

a. Take reasonable steps to obtain information relevant to the audit. Auditors should take into account information from the institution, the Council, any changes in legislation, and the results of previous audit work.

b. Keep up to date with developments in professional matters.

c. Look out for and take into account any unusual circumstances.

d. Consider audit objectives and plan work to adhere to them while taking into account the institution's risk management strategy.

e. Document the conclusions arising from the planning process, and detail a budget for staff and time.

f. Discuss the main features of the audit with the institution.

g. Ensure that audits are staffed with suitably qualified and experienced personnel, and that work is properly controlled and reviewed.

h. Co-ordinate the work of specialist staff.

i. Ensure that conclusions are adequately supported by reliable evidence. This evidence should be sufficient for an experienced auditor with no previous connection with the audit to ascertain what work was done and how the conclusions were reached.

j. Control costs of audit, and weigh costs and likely benefits.

k. Maintain independence but also make their expertise available in the form of advice to management.

l. Preserve confidentiality where appropriate.

Audit arrangements for the Higher Education Funding Council for England

HEFCE

26. The HEFCE's Chief Executive is Accounting Officer for the funds received from the DfES and is accountable to Parliament for them. The Accounting Officer must therefore be satisfied that institutions are making proper arrangements to safeguard such funds and use them effectively. The Council itself also has a responsibility; to help it discharge this, it has established an Audit Committee, whose terms of reference are based on the model terms set out in Annex B.

HEFCE Audit Service

27. The Financial Memorandum between the DfES and the Council requires the establishment of an internal audit function. This function will be discharged by the HEFCE Audit Service. The HEFCEAS will be externally tested in accordance with the guidance in Annex C.

Role

28. The HEFCEAS is responsible for evaluating all control and risk management arrangements, financial and otherwise, of the Council and of institutions funded by the Council, and for giving assurance to the Council and the Accounting Officer on those control arrangements.

29. The HEFCEAS has no executive role nor does it have any responsibility for the development, implementation or operation of systems. However, it may provide advice on control and related matters, subject to the need to maintain objectivity.

Scope

30. All the Council's activities are within the remit of the HEFCEAS. It will consider whether the system of controls is adequate to manage risk and to secure propriety, efficiency, economy and effectiveness in all areas. It will seek to confirm that management have taken the necessary steps to achieve these objectives.

31. All institutions receiving funding from the Council fall within the scope of HEFCEAS review. Rights of access to undertake examination of internal financial and management controls are provided in the Financial Memorandum between the Council and each institution.

Responsibilities

32. The HEFCEAS will undertake a programme of work, in accordance with HM Treasury standards, to provide an independent and objective appraisal service on risk management, control and governance and to provide advice on those matters

Access

33. The HEFCE’s Chief Auditor has a direct right of access to the HEFCE Accounting Officer and the Chairman of the HEFCE Audit Committee and, if necessary, the Chairman of the Council.

34. The HEFCEAS has access to all HEFCE records, information and assets, and can require any officer to give any explanation which it considers necessary to fulfil its responsibilities. It has the same rights in respect of each institution funded by the Council.

Reporting

35. For day to day administrative purposes only, the Chief Auditor reports to the HEFCE’s Director of Finance and Corporate Resources. The Chief Auditor will, when appropriate, draw the attention of the Accounting Officer and the HEFCE Audit Committee to serious weaknesses, significant frauds and any major accounting breakdowns.

36. The Chief Auditor will submit an annual report to the Council's Audit Committee and the Accounting Officer. This report will include the Chief Auditor's assessment of the adequacy and effectiveness of the risk management, control and governance processes, a report on coverage achieved and a set of internal audit performance measures.

37. The HEFCEAS will normally produce a draft report within 15 working days of completing each audit, giving an opinion on the area reviewed and making recommendations where appropriate. The HEFCEAS will ask institutions to respond within one month and will issue a final report within 15 working days of a final draft being agreed. Audit reports will be discussed and the facts agreed. Each report will include an agreed action plan for improvement. Fundamental and significant recommendations will be followed up in accordance with the action plan. All final versions of audit reports will be copied to the Council's Chief Executive.

Standards

38. The HEFCEAS will conform to the standards for internal audit laid down in the Auditing Guideline 'Guidance for Internal Auditors', issued by the Auditing Practices Committee in June 1990. Due regard will also be given to the advice in the Government Internal Audit Standards issued by HM Treasury, and to guidance from professional auditing and accountancy bodies. The Chief Auditor will monitor compliance with these standards and report as appropriate to the HEFCE’s Audit Committee. In addition, the Audit Committee will consider a range of performance measures and receive any assessments of the HEFCEAS by the DfES Internal Audit Service.

Liaison

39. The HEFCEAS will liaise, whenever appropriate, with the NAO, the institutions' internal and external auditors, the DfES, the TTA, the Scottish Higher Education Funding Council, the Higher Education Funding Council for Wales, the DEL and any other appropriate HEFCE officer or relevant organisation.

Approach

40. In achieving its objectives, the HEFCEAS will do the following for the Council:

a. Identify all elements of the internal control and risk management system on which the Council intends to rely, assess audit needs and establish a review strategy.

b. Evaluate those systems, identify inappropriate or inadequate or excessive controls, and recommend improvements in procedures and practices.

c. Undertake examinations to ensure that those systems of control are laid down and operate to promote the most effective, efficient and economic use of resources.

41. The HEFCEAS will also do the following in respect of institutions:

a. Establish whether all elements of the internal control and risk management system on which each institution intends to rely have been identified by institutional auditors; that audit needs have been assessed adequately and review strategies established; and that audit arrangements are consistent with the Code.

b. Consider institutions' internal control and risk management arrangements – partly through a cycle of visits – with a view to relying on them, and where appropriate recommending improvements. Each cyclical visit to an institution will seek to gain an overview of the adequacy and effectiveness of the internal control arrangements in place. As part of our policy of reducing audit burden wherever possible, each institution will receive at least one cyclical audit visit in each five year-period as opposed to three yearly as in the past. To minimise duplication, the HEFCEAS will rely on the work carried out by the institution's internal and external auditors where appropriate. The HEFCEAS will also seek to rely on assurances from the institution so long as those assurances are considered to be well-founded. Where the assurances do provide comfort and where the audit arrangements are considered satisfactory, the HEFCEAS will need to undertake its own reviews less frequently. The specific assurances that influence this risk assessment include the corporate governance statements in the financial statements (and the Combined Code statement from 2002-03), the audit committee annual report, the external audit management letter, the internal audit annual report and the annual operating statement. The HEFCEAS has also introduced a brief audit return to supplement the audit committee annual report, which will keep it up to date with institutional audit and accountability developments in the longer intervals between audit visits. The return is shown at Annex I.

c. In practice, a HEFCEAS cyclical audit will normally require a three-day visit to the institution by an experienced and qualified auditor working to professional standards. The auditor will be seeking to ensure that the institution has a sound system of corporate governance, effective audit arrangements and effective high level strategic, risk and financial management. The HEFCE auditor will not be attempting to provide direct assurance about the whole system of internal control: that is the role of the institution’s internal audit service. However, exceptionally the HEFCEAS will seek to undertake direct auditing of systems where a problem with a system is identified and institutional auditors have been unable to provide satisfactory assurances. Each HEFCE audit will result in a brief report to the designated officer and audit committee, which will be followed up as necessary.

42. HE institutions are required to furnish the HEFCE with data which inform its allocation of funding generally, and in response to specific initiatives. These data may be supplied directly or through the Higher Education Statistics Agency. The HEFCE has procedures for validating and verifying data received, and may undertake audit work to satisfy itself that the information supplied is reliable. As a consequence, the HEFCEAS undertakes programmes of data audit. The scope and conduct of such reviews varies, but normally involves visits to institutions to evaluate the systems which generate data and to verify data on a sample basis.

Value for money

43. The HEFCE is responsible for promoting value for money across the higher education sector to ensure that systems of control are laid down and that those systems operate to promote the most effective, efficient and economic use of resources. This work includes a programme of value for money studies in co-operation with other UK funding bodies. These studies are for the benefit of institutions and are performed after appropriate consultation. The emphasis of such national studies is to disseminate good practice and to support institutions conducting their own reviews at a local level. The national studies are followed up to determine the extent to which good practice is being adopted in the sector. In addition, the HEFCEAS cyclical visits will examine the approach to value for money adopted by institutions. The HEFCEAS will maintain information and guidance on value for money, including a model strategy, which is available to institutions on request.

44. The HEFCEAS will also consider conducting any special reviews requested by the Accounting Officer of the Council. This includes work necessary to fulfil the HEFCE's contractual obligations with the DEL in Northern Ireland.

Audit committees in higher education

45. The governing body of an institution must ensure that it is fulfilling its responsibilities for proper financial management, for the effectiveness of the internal control and management systems, for risk management, and for the economy, efficiency and effectiveness of the institution's activities. Accordingly, institutions are required by their Financial Memorandum with the Council to appoint an audit committee. The duties of the audit committee will have to be determined in the light of the institution's needs, but should normally include those described in the model terms of reference at Annex B. Additional information on the role of audit committees is available from the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Institute of Chartered Accountants in England and Wales (ICAEW). See the CIPFA 'Handbook for audit committee members in further and higher education', published in 1996, and the ICAEW Audit Faculty guidance 'Audit committees: a framework for assessment', issued in 1997.

46. The audit committee is fundamentally important in the higher education accountability framework. It ensures that it has adequate and reliable audit information to inform the advice it gives to the governing body. This calls for an independent and challenging approach to its dialogues with those officers and with senior managers in the institution. The audit committee should be properly constituted, appointed and given sufficient authority and resources by the governing body. It should have the right to obtain all the information it considers necessary and to consult directly with the internal and external auditors. The committee should be advisory and should report (or have the right to report) directly to the governing body. It should consist of at least three members of the governing body, and should be able to co-opt others with particular expertise or interests who are not members of the governing body.

47. A co-opted member of the audit committee should not normally be appointed as its chairman, since the chairman has to be able to attend, as of right, all meetings of the governing body. Where this is unavoidable, arrangements should be made to ensure the chairman has full access to the governing body for reporting purposes. Subject to this, co-opted members should be treated as having equivalent status on the audit committee as full governing body members. The committee should have the right, whenever it is satisfied that it is appropriate, to go into confidential session and exclude any, or all, participants and observers.

48. *(Updated 16 September 2002.)* At least one audit committee member should have a background in finance, accounting or auditing. To ensure independence and objectivity, members must not have executive authority. If members with executive authority are appointed, they should be in the minority and should not hold the chair. Audit committee members should not be members of a finance committee or its equivalent, unless the institution can satisfy the HEFCE that there are good grounds for no more than one member to sit on both committees and that the following conditions are met:

- the audit committee has at least three members (not counting co-options)
- the person serving on both committees is not the chair of either
- in institutions where there is a Treasurer, that individual does not serve on both committees.

There should also be some mechanism for members with executive authority or individuals who are also finance committee members to declare an interest in any matter that impinges on their other responsibilities; they may then be excluded from consideration of such items. The chairman of the governing body should not normally be a member of the audit committee. Care should be taken in the appointment of governors with a significant interest in the institution (including staff governors) to ensure that the independence and objectivity of the committee are preserved.

49. The audit committee should consider whether members, or prospective members, require any training on internal control, finance, audit or other related matters. Visits to the finance department could contribute to this process. Committee members should normally be provided with a copy of the guidance on audit committees issued by CIPFA and the ICAEW. Further advice on any aspect of audit committee membership is available from the HEFCEAS.

50. The audit committee should be given maximum discretion to determine its proceedings, within the terms of reference set for it by the governing body. The committee should usually meet at least twice in each financial year. Most institutions find three or four meetings more appropriate. The timing and content of the meetings should follow, as far as possible, the planning and reporting cycles of external and internal audit. Senior and other staff, not just the head of finance (or equivalent), should be invited to attend audit committee meetings, particularly where their area of responsibility is under examination. The internal auditor should normally attend all meetings. The external auditors should normally attend meetings where business relevant to them is to be discussed. Both the internal and external auditors should have the right of access to the chairman of the committee, and the right to ask the chairman to convene a meeting if necessary.

51. The clerk to the governing body or some other independent person should normally be the clerk to the audit committee. Where the clerk has significant financial or other responsibilities at senior management level within the institution, the governing body should consider whether the role of clerk to the committee should be transferred to another individual to maintain independence, or whether sufficient safeguards are built into the existing arrangements.

52. The audit committee should also identify and approve appropriate performance measures for internal and external audit and monitor their performance annually. The HEFCEAS can provide guidance on suitable performance measures.

53. The audit committee should consider significant individual audit findings or recommendations, but need not be concerned with more detailed findings, unless the committee considers it valuable to do so. The committee should concentrate on gaining assurance that the institution's systems of risk management and internal control are adequate and effective, for example through the internal auditors' opinions of the activities and systems they have reviewed, through external audit and other audit related work. For this purpose, the audit committee should ensure there is an adequate system to monitor the implementation of agreed audit recommendations. The governing body, advised by the audit committee, should ultimately be responsible either for ensuring that management take prompt and effective action on those audit reports which call for it, or for recognising and accepting the risks of management not taking action.

54. The committee will have a role in appraising the effectiveness of the institution's risk management strategy, in part because the committee's advice will be sought before the governing

body can agree the internal control and risk management statements for inclusion in published financial statements from 2002-03. The HEFCEAS will issue guidance on the role of the audit committee in risk management in an Audit Practice Note to be published in 2002.

55. The audit committee, advised by management and its internal audit service, must satisfy itself that satisfactory arrangements are in place to promote economy, efficiency and effectiveness. For this purpose, audit committees should consider institutional value for money strategies, and receive reports monitoring compliance with the strategy.

56. The audit committee will be concerned with both internal financial control and the wider aspects of internal control. In this context financial control covers areas such as the maintenance of proper accounting records, reliability of financial information, the safeguarding of assets and the proper use of public funds. The wider aspects of internal control cover non-financial controls and compliance with laws and regulations. This interest also extends to good corporate governance as it forms part of the system of internal control.

57. Audit committees may review the draft annual financial statements, although care should be taken to avoid work that properly belongs to the finance committee. Where the financial statements are reviewed, the audit committee should consider the external audit opinion, the statement of members' responsibilities and any relevant issue raised in the external auditor's management letter. The committee should confirm with the internal and external auditors that the effectiveness of the internal control system has been reviewed, and comment on this in its annual report to the governing body. In addition, for the interim period 2001-02, the committee should review the corporate governance statement where one is provided.

58. The committee must produce an annual report for the governing body and the designated officer. When they have considered the report, it must be sent without delay to the Chief Auditor of the Council. The audit committee annual report should normally be submitted to the governing body before the members' responsibility statement in the annual financial statements is signed. It is normal practice for institutions to submit their internal auditor's annual report to the HEFCEAS along with their audit committee report. All institutions are invited to follow this practice since it informs the Chief Auditor's institutional risk assessment.

59. The audit committee annual report should include the committee's opinion on the extent to which the governing body may rely on the institution's internal control system, the effectiveness of the risk management strategy and the arrangements for promoting economy, efficiency and effectiveness, in the discharge of its responsibilities. (This opinion should be based upon the information presented to the committee.) Such a report should also record the work of the committee, and consider the following:

- the external auditors' management letter
- the internal auditors' annual report
- any value for money work
- any HEFCEAS or other relevant evaluation.

60. The report might also identify any key issues for the institution arising out of its activity over the year. Further guidance on the content of the audit committee annual report is given in Annex H. The audit committee will need to ensure that in the event of the merger or dissolution of the institution the necessary audit actions are completed. This includes arranging for a final set of financial statements to be completed and signed.

Internal audit arrangements in higher education institutions

61. Each institution is required by its Financial Memorandum with the Council to have an internal audit function. Professional standards for internal audit, for example as laid down in HM Treasury Standards (Government Internal Audit Standards, HM Treasury, October 2001), have changed in recent times to reflect a greater recognition of the importance of risk management and corporate governance.

62. The prime responsibility of the internal audit service is to provide the governing body, the designated officer and the other managers of the institution with assurance on the adequacy and effectiveness of the internal control system, including risk management and governance. Responsibility for internal control remains fully with management, who should recognise that internal audit can only provide 'reasonable assurance' and cannot provide any guarantee against material errors, loss or fraud. Internal audit also play a valuable role in helping management to improve systems of internal control and so reduce the potential effects of any significant risks faced by the institution. Risk management provides the opportunity for internal audit work to be efficient and focused: it does not necessarily imply that internal audit activity has to be increased.

63. Internal audit can also provide independent and objective consultancy advice specifically to help management improve the internal control system, including risk management and governance. In such circumstances, internal auditors apply their professional skills in a systematic and disciplined way to contribute to the achievement of corporate objectives. Such advisory work contributes to the opinion which internal audit provides on internal control, including risk management and governance.

<u>Role, scope and terms of reference</u>

64. An institution must ensure that it has sound systems of control. These help to ensure:

a. That the institution's objectives are achieved as far as possible and that associated risks are managed.

b. That the economical, efficient and effective use of resources is promoted.

c. Adherence to management's policies, directives and established procedures, and compliance with any relevant laws or regulations.

d. That the institution's assets and interests are safeguarded – particularly from losses arising from fraud, irregularity or corruption.

e. As far as reasonably practicable, the integrity and reliability of accounting records and other information.

65. Accordingly, the internal audit service must embrace the whole internal control system of the institution, including all its operations, resources, staff, services and responsibilities for other bodies. It should cover all activities associated with the institution, including those not funded by the HEFCE.

For example, it should review controls that protect the institution in its dealings with any subsidiary or associated company or student union, or any other activity in which the institution has an interest.

66. The internal audit service will need to take risk into account in the following ways:

a. The internal audit strategy should be informed by the auditor's own estimate of relative risk. This assessment will influence the amount of audit attention given to different systems and the frequency of such work. The auditor's risk assessment will, in turn, be informed by management perceptions of risk.

b. The internal audit strategy will be aimed at providing an assurance on the effectiveness of control, including the institution's risk management strategy. This assurance will result from the overall work of the auditor but it may also require the risk management strategy to be an auditable entity within audit plans.

c. The internal auditor will usually be an appropriate individual to advise management on the development and implementation of its risk management strategy. The internal auditor should not be responsible for the strategy, however, since this will compromise the opinion that the auditor can give on it.

67. While it is the responsibility of management to promote value for money, internal auditors can specifically assist with this process as they have a responsibility to consider value for money in their routine audit work. This will include considering:

- systems for planning, budgeting and controlling capital and revenue income and expenditure
- personnel, estates and information systems management
- arrangements for managing the assets of the institution
- proper codification of responsibilities, authority and accountability
- monitoring results against predetermined objectives.

68. In view of their independence and professional expertise in review, analysis and investigative work, internal auditors are often regarded as particularly suited to conducting or assisting with value for money studies. The internal audit service's terms of reference should identify separately any responsibility it may have in initiating, conducting or participating in such studies. Specialists may also be engaged to work under the direction of, alongside, or as an alternative to internal auditors. The emphasis of such work should be to help management meet their responsibility for securing the economic, efficient and effective use of resources. Apart from any reporting arising as part of routine audit work, the internal auditor should advise the audit committee and the designated officer in the internal audit annual report whether proper arrangements are in place to promote economy, efficiency and effectiveness.

69. Auditors should not question policy objectives, but should consider the effects of policy, the arrangements by which policy objectives have been determined and the means for delivering those objectives.

70. Internal auditors should not perform academic audit. However, they may review whether an institution has adequate arrangements to deliver effective academic audit. The audit committee may wish to consider including such work in audit plans or to consider its own terms of reference in this regard.

71. Internal auditors should also assess the adequacy of the arrangements to prevent and detect irregularities, fraud and corruption. However, the primary responsibility for preventing and detecting corruption, fraud and irregularities rests with management, who should institute adequate systems of internal control, including clear objectives, segregation of duties and authorisation procedures.

72. The internal audit service should have formal terms of reference, agreed by the governing body on the recommendation of the audit committee. Model terms are set out in Annex D; however, local circumstances may vary and institutions may have to modify these. The terms of reference should form part of any contract for the provision of internal audit services by external providers. This should be made clear when seeking proposals for the provision of internal audit services.

Independence and status

73. Independence is fundamental to the effectiveness of internal audit. Therefore, while the auditor should consult with senior management on audit plans, these plans should be submitted to, and be approved by, the governing body on the recommendation of the audit committee or directly by the audit committee under delegated authority. Internal auditors may carry out additional work at the request of management, including investigations, provided such work does not compromise the objectivity and independence of the audit service or the achievement of the audit plan. Accordingly, each institution's audit committee should satisfy itself that the independence of the internal audit service has not been affected by the extent and nature of other work carried out.

74. Internal audit services should not have any management responsibilities other than for internal audit. For day to day administrative purposes, the internal audit service may be responsible to a senior officer within the institution, such as the clerk or secretary. The reporting arrangements should take account of the nature of audit work undertaken.

75. Internal audit should be seen to have sufficient status, respect and support within the institution. To be effective, the head of internal audit, or equivalent where the service is provided on a contract basis, must have direct access to the institution's designated officer and to the governing body (normally through the chairman of the audit committee), and, if necessary, to the chairman of the governing body. Internal auditors must also have unrestricted access to all records, assets, personnel and premises, and be authorised to obtain whatever information and explanations are considered necessary by the head of the internal audit service.

Approach to assignments

76. The internal audit service should adopt a risk based approach to planning its work. When undertaking individual reviews, the internal audit service should normally adopt a systems-based approach to audit assignments, as recommended in professional standards. A system is a set of related activities designed to operate together to achieve a planned objective. The internal audit service should therefore identify the objectives of systems. Where stated management objectives are inadequate to characterise systems, the internal audit service should clarify appropriate objectives with management. The prime objective in a systems audit should be to evaluate the extent to which the controls in the system are adequate and may be relied upon to ensure the objectives of the system are met.

77. To achieve this the internal audit service should:

- identify and record objectives, activities and controls
- establish the congruence of the objectives with higher level corporate objectives
- evaluate the risk analysis, taking account of management’s acceptance of specific risks
- evaluate the controls in principle to decide whether or not they are appropriate and can be reasonably relied upon to achieve their purpose
- identify any instances of over-control
- evaluate the impact of any decision by management to accept significant risk(s) rather than transfer or control them
- determine an appropriate risk-based strategy to test the effectiveness of risk management and controls
- arrive at conclusions and report, making recommendations as necessary and providing an opinion on the adequacy and effectiveness of risk management and control in the audited areas.

78. This approach enables the internal audit service to reach the conclusions necessary to form an opinion on individual systems and the whole framework of internal control and risk management. Such opinions should be clearly stated in assignment reports and the internal audit annual report.

79. It is the auditor’s responsibility to alert the designated officer and the audit committee to the extent to which the institution and its governing body could be exposed by any shortcomings in the system under review. The degree of control should be related to the risks involved, but it is management's role to exercise judgement in establishing the balance between risk and control.

Strategy and planning

80. The work of the internal audit service should be planned at each level of operation. The overall plan should be based on an audit risk assessment and strategy which should be continually maintained and subject to periodic (normally annual) consideration and approval by the audit committee on behalf of the governing body.

81. The internal auditor should develop the strategy from an analysis of the institution's systems and risks to assess the audit need. This enables the internal audit service to see systems in terms of

their relative risk and significance, and the relationships between them. The auditor should provide details of all systems identified even though they may not be recommended for review in the audit plans, so that the audit committee has more information on which to base its judgement of the assessment of resources needed to deliver the strategy.

82. Where existing resources are inadequate to meet the need identified, the head of the internal audit service should draw this fact to the attention of the designated officer and the governing body through the audit committee. The governing body should decide, on the advice of the audit committee, what level of resources should then be provided.

83. Further guidance on audit planning is provided at Annex E. The guidance is based on HM Treasury standards.

Reporting

84. The internal audit reporting arrangements should be determined by institutions after consideration by their audit committee. It is important that the reporting arrangements do not compromise the independence or objectivity of the internal audit service.

85. At the end of each audit assignment, the internal audit service should provide a written report which sets out the findings, conclusions and recommendations arising. At least for all systems-based audits, it should also give an opinion on the adequacy and effectiveness of the system.

86. The internal audit service must produce an annual report of its activities. This should be addressed to the governing body and the designated officer, and should be considered by the audit committee. The audit committee may forward the report to the governing body with its own report. The report should be for the institution's accounting period and be submitted to the designated officer when it is available, and to the audit committee at least for the first meeting of the following financial year. As a minimum it should include the internal auditor's opinion of the adequacy and effectiveness of the internal control system and the extent to which the governing body can rely on it. This opinion should be placed into its proper context: that is, the work undertaken has been based on the audit needs assessment and on the systems reviewed in the year, as well as incorporating knowledge of systems audited in previous years (including from a previous auditor). The report should also provide an opinion on the arrangements for securing value for money. Internal audit performance measures should be provided, including stating achieved coverage against the original audit plan. It should also draw attention to any significant audit recommendations which the internal audit service considers have not received adequate management attention.

Risk management

87. The internal audit service should contribute to the improvement of risk management and control in the institution. This should be achieved by monitoring and evaluating the effectiveness of the overall risk strategy in addressing significant risks to:

- the reliability and integrity of financial and other information

- the effectiveness and efficiency of operations
- the safeguarding of assets
- compliance with laws, regulations and contracts.

88. An internal auditor may be involved more actively in the early stages of institutional risk management because of his or her expertise. This is understandable because management may want to obtain the auditor's advice. In such circumstances, there is a potential for the auditor's own opinion on institutional risk management to be, or seem to be, compromised by his or her involvement. Therefore, where internal auditors are involved in establishing risk management the external auditor should be asked to provide a second opinion on risk management, at least until the arrangements are established and the internal auditors can detach themselves from their management involvement.

Control self-assessment (CSA)

89. Control self-assessment – also known as control and risk self-assessment (CRSA) – is a technique which some organisations in the public and private sector use to assess the risks in their organisation and identify the controls needed to manage those risks. This can increase understanding of risk and control within an organisation, and so improve the efficiency and effectiveness of controls. The internal auditor, or an alternative facilitator, may help management conduct a 'self-assessment'. There are a number of approaches, including questionnaire-based and workshop-based methods.

90. The advantages of self-assessment include the following:

a. It strengthens management understanding both of risk, and of their responsibility for establishing and maintaining the internal control system needed to manage risk.
b. It provides additional evidence for the external auditors, internal auditors, the designated officer and the audit committee in assessing the state of the internal control system.
c. It can provide greater coverage of the control system than is normally feasible by the internal auditors alone, and could allow the internal audit service to reduce its routine work, so allowing greater focus on higher risk areas.
d. It can enhance the relationship between management and the internal audit service.

91. CSA and the more traditional approach to internal audit are not mutually exclusive. While it is for institutions to decide whether or not to use CSA, the HEFCEAS encourages the use of self-assessment techniques to supplement, but not replace, internal audit work. The institution's audit committee should be specifically advised of the use of CSA. Where appropriate, any reports from the use of CSA should inform both the internal audit and audit committee annual reports. Although internal auditors can help management to establish, facilitate and review a self-assessment process, owning and operating it are still the responsibility of management.

Provision of service

92. There are a variety of ways to acquire an internal audit service. One possibility is to appoint a head of internal audit and staff as necessary. An 'in-house' team may also be supplemented from time to time with external consultants or contractors, under the direction of the head of internal audit, to meet any peaks in workload or to provide specialist skills.

93. Another option is to form a consortium with one or more other institutions, on a geographical or common interest basis. A consortium may be organised in-house, be provided externally or as a mixture of the two. A number of institutions have set up such consortium arrangements.

94. A third option is to contract directly with an external provider, such as another institution, an accountancy firm, health authority or local authority. We would expect that the same firm should not normally be appointed as both internal and external auditors because this can lead to a loss of objectivity and independence. Where use of the same firm for both services is considered to be appropriate to the institution’s circumstances, reference should be made to Annex C, paragraph 7. It is important to note that internal and external auditors have different roles and responsibilities. In particular, external audit may need to be satisfied that the internal audit function is operating effectively.

95. Each institution, advised by its audit committee, should establish which is the most suitable and cost-effective way of obtaining internal audit services. However, at least every seven years, it should consider market testing internal audit services, since this provides a powerful incentive to maintain both quality and cost effectiveness. This external testing should take into account the guidance set out in Annex C.

Standards

96. The operation and conduct of the internal audit service should conform to the standards laid down in HM Treasury Standards. Internal auditors should also have regard to advice provided by professional auditing and accountancy bodies, and any guidance produced by the HEFCE.

97. The head of internal audit should implement measures to monitor the effectiveness of the service and compliance with standards. The audit committee should consider and approve these performance measures. The committee should also consider asking the external auditor to provide an independent assessment of internal audit's effectiveness. This information should be used to contribute towards the committee’s annual assessment of the performance of the internal audit service. A list of suitable performance measures is available on request from the HEFCEAS.

Change of internal audit service

98. Internal audit working papers are the property of the institution. This should be made clear in the auditors’ terms of engagement. If institutions change their internal auditors, they should make arrangements for relevant audit documentation to be passed to the incoming auditor. This will ease transition and avoid costly repetition of work. Incoming auditors can then seek to rely on the work of

the previous auditor in preparing the audit needs assessment, audit plans and annual report. Institutions should also consider making arrangements for the incoming and outgoing auditors to meet. Where internal audit services are provided on a contractual basis, such arrangements should be included in the formal contract or terms of engagement.

99. Where internal audit is provided on a contract basis, the institution should agree a fixed term of office based on financial years, and consider market testing before the contract expiry date. Provision should be made for outgoing auditors to complete their work and submit an annual report after expiry of the contract term. Attendance by the auditors at the appropriate audit committee should also be considered. In the event of a change in auditor, institutions should ensure that the new contract immediately follows the end of the old contract or other arrangements.

Removal or resignation of auditors

100. Subject to normal staffing arrangements (for ‘in-house’ auditors) and any contractual arrangements in place, only the governing body (or the audit committee where delegated authority exists) may pass a resolution to remove the internal auditors before the end of their term of office if serious shortcomings are identified.

101. Where internal auditors cease to hold office for any reason, they should provide the governing body with either a statement of any circumstances connected with their removal which they consider should be brought to the governing body's attention, or a statement that there are no such circumstances. The internal auditors may also request an extraordinary general meeting of the governing body to consider the statement. Any such statements should also be sent to the HEFCEAS by the institution or, if it fails to do so, by the outgoing internal auditors.

102. The governing body must inform the Council's Chief Auditor without delay of the removal or resignation of the internal auditors.

Restriction of auditors’ liability

103. Where the internal audit service is provided through a contractual arrangement with an external provider, the provider may ask the institution to agree to a restriction in the auditors’ liability arising from any default by the auditors. Normally such liability should be without limit. However, institutions may negotiate a restriction in liability so long as the decision is made on an informed basis. The governing body, through the audit committee, should be specifically notified of any such request for a liability restriction. Further information on liability restriction is provided in paragraph 6i of Annex C.

Fraud and corruption

104. Each institution’s management is responsible for the prevention, detection and investigation of irregularities, including fraud and corruption. To discharge this responsibility, management should ensure that an adequate system of internal control is operated. It is not a primary function of internal audit to detect fraud. However, the work of the internal audit service, in reviewing the adequacy and effectiveness of the internal control system, should help management to prevent and detect fraud. The internal audit service should ensure that it has the right to review, appraise and report on the extent to which assets and interests are safeguarded from fraud. When internal auditors suspect fraud, or are carrying out a fraud investigation, it is important to safeguard evidence. They should assess the extent of complicity to minimise the risk of information being provided to those involved, and the risk of misleading information being obtained from them.

105. Internal auditors should report serious weaknesses, significant fraud or major accounting breakdowns to the designated officer without delay. The designated officer must then inform the chairman of the audit committee, the chairman of the governing body and the HEFCE Accounting Officer of such matters without delay. If he or she refuses to do so, then the internal auditor must report to them directly.

106. The institution should ensure that the internal auditor is informed, as soon as possible, of all attempted, suspected or actual fraud or irregularity. The internal auditor should consider any implications in relation to the internal control system, and make recommendations to management, as appropriate, to strengthen the systems and controls. See also paragraphs 19 and 20 of this Code for further information.

Relationship with other auditors

107. There should be regular liaison between internal auditors, the institution's external auditors and the HEFCEAS to enhance the level of service provided to the institution. External auditors should be given access to the internal audit service's working papers and plans so that their work programmes can be adjusted accordingly, and so that the extent of their reliance on the work of the internal audit service can be determined.

108. Copies of the internal audit service's reports should be available to the external auditors. The internal audit service should also receive copies of the external auditor's plans and management letters, and any other relevant reports produced for the institution by other agencies. The HEFCEAS must be allowed access to any work of the internal auditor, including the annual report, or correspondence between the internal and external auditors.

Value for money

109. Internal audit has a specific role to play in supporting the governing body and management with their responsibilities for obtaining value for money from the funds provided. This may include, for example, being a member of a value for money steering group. All internal audit work should be conducted with value for money in mind. Any value for money opportunities should be identified during

audit planning and routine audit work, and be reported accordingly. Internal audit may carry out or participate in value for money studies undertaken at the institution, providing such work does not affect the ability of the auditor to complete the audit work necessary for the assurance provided in the annual report. Internal audit should also provide the designated officer and governing body, in the internal audit annual report, with its view on whether proper arrangements are in place to promote economy, efficiency and effectiveness.

External audit arrangements in higher education institutions

Role of external auditors

110. The primary role of external auditors is to report on the financial statements of institutions, and to carry out whatever examination of the statements and underlying records and control systems is necessary to reach their opinion on the statements. Their report should also state whether recurrent and specific grants and income from the HEFCE (and other bodies and restricted funds where appropriate) have been properly applied for the purposes provided, and in accordance with the institution’s Financial Memorandum with the Council.

Qualification of external auditors

111. The qualifications required for external auditors of higher education corporations are as set out in paragraph 59(b) of Schedule 8 of the Further and Higher Education Act 1992. For other institutions, the requirements are the same as under the Companies Act 1985. Auditors should be registered with one of the appropriate professional bodies.

Selection criteria and procedures

112. The governing body is usually responsible for appointing external auditors, although it may delegate this to the audit committee. Before receiving proposals, the institution should determine selection criteria, procedures, and the frequency of external testing, taking into account the guidance given at Annex C. Particular attention should be given to such issues as:

- quality of service, including experience
- audit fees, including a clear commitment on future fee increases.

Letter of engagement

113. The duties of institutions and external auditors should be clearly presented in the agreed terms of reference. The external auditors' letter of engagement should not depart in any material way from the guidance set out in the model at Annex F. Where significant differences from the model are under consideration, a copy of the proposed letter should be sent to the HEFCE’s Chief Auditor without delay.

Additional services

114. Institutions may ask external auditors to provide services beyond the scope of the audit of the financial statements, including special investigation work, taxation compliance and advice, consultancy, and value for money reviews. Generally, it is a matter for institutions and auditors to agree precise requirements, and the audit committee should be informed of any work undertaken. However, any additional work should not impair the independence of the audit function and so should normally be the responsibility of different staff within the firm of auditors.

115. The audit committee has a key role to play where the auditors supply a substantial amount of non-audit services. The committee should keep the nature and extent of such services under review, seeking to balance independence and objectivity with the institution's needs. (See also paragraph 129 in connection with audit liability.) We would expect that the same firm would not be appointed as both internal and external auditors because this can lead to a loss of objectivity and independence. Where using the same firm for both services is considered appropriate to the institution's circumstances, reference should be made to Annex C, paragraph 7. It is important to note that internal and external auditors have different roles and responsibilities. In particular, external audit may need to be satisfied that the internal audit function is operating effectively.

116. In order to help judge the relationship between the institution and its external auditors, the institution must disclose separately, by way of a note to its financial statements, the fees paid to its external auditors for other services. Each institution's audit committee should review the level of fees and satisfy itself that the extent and nature of other work have not affected the independence of the external audit.

Reporting arrangements

117. External audit should report to the institution by way of a management letter which highlights any significant accounting and control issues arising from the audit. The Code is not prescriptive about the format or title of such a letter but it should enable the HEFCEAS to see what observations have been made about the internal control system and how management have responded. The letter influences the HEFCEAS's risk assessment of each institution. Where the external auditors record their opinion on the effectiveness of the internal auditor in the management letter this will be used in the HEFCEAS risk assessment process.

118. It is not sufficient to report in general and in brief that some matters were raised and responses received. The letter, with management responses, should be made available (in draft if necessary) to the institution's audit committee in time to inform the committee's annual report, and in any event no later than two months after issuing an opinion on the financial statements. Institutions must send two copies of the final management letter (incorporating management responses) to the HEFCE Chief Auditor by 28 February in the following year, by which time it should have been seen by the audit committee and/or governing body. External auditors should attend governing body (finance committee) and audit committee meetings at which the audited financial statements are discussed, and attend other meetings when appropriate.

Audit report

119. The external auditors shall report whether:

a. The financial statements give a true and fair view of the state of the institution's affairs and of its income and expenditure, recognised gains and losses, and statement of cashflow for the year. They should take into account relevant statutory and other mandatory disclosure and accounting requirements, and HEFCE requirements.

b. Funds from whatever source administered by the institution for specific purposes have been properly applied to those purposes and, if relevant, managed in accordance with relevant legislation.

c. Funds provided by the HEFCE have been applied in accordance with the Financial Memorandum and any other terms and conditions attached to them. In particular, auditors should have regard to the specific requirements of the Financial Memorandum, such as compliance with the short-term and long-term borrowing conditions, and the offering of security over Exchequer-funded assets.

d. The financial statements comply with the Companies Act 1985 (where the institution is incorporated under the Companies Act) and, where appropriate, the Statement of Recommended Practice on Accounting in Higher Education Institutions (SORP) or other legislative or regulatory requirements. In addition, the HEFCE issues an annual Accounts Direction (see HEFCE Circular Letter 24/00 for the Accounts Direction for 2000-01). The Accounts Direction now specifies that the statement on corporate governance will need to incorporate statements on internal control and risk management. Some institutions will need to be able to make a full statement for the year ending 31 July 2002 but all institutions will be required to do so by 31 July 2003.

120. Institutions may ask external auditors, usually through a separate letter of engagement, to review statements of corporate governance included within the annual financial statements. From 2002-03, when the institution reviews the effectiveness of its internal control and risk management system, the external auditor may be invited to examine this review. External auditors may report privately to the governing body (through the audit committee) on the results of their work, or may make reference to this review in the financial statements, either in their audit opinion report or through a separate report.

121. A model external audit report for an institution's annual financial statements is given at Annex G.

Reappointment of external auditors

122. Institutions should reappoint auditors formally each year. The audit committee should assess the auditors' work each year to ensure that it is of a sufficiently high standard and at a reasonable price. The committee should then make a recommendation to the governing body regarding the reappointment of the auditors. Performance measures could be used as part of the assessment. Provided that the auditors' performance is satisfactory, it will not be necessary to repeat the full selection process each year. However, market testing should be considered at least every seven years. One partner in the firm is normally responsible for the institution's audit; he or she should not hold this position for more than seven continuous years. See also Annex C paragraph 2.

Removal or resignation of auditors

123. The governing body may pass a resolution to remove the auditors before the end of their term of office if serious shortcomings are identified.

124. External auditors who have resigned or been removed from office for whatever reason should be entitled to attend, and make representations to, the general meeting of the governing body at which their term of office would have expired, or at which it is proposed to fill the vacancy caused by the resignation or removal. They are entitled to receive notices of, or other communications relating to, that meeting, and to be heard on any part of the business which concerns them as former auditors of the institution.

125. Where auditors cease to hold office for any reason, they should provide the governing body with either a statement of any circumstances connected with their removal which they consider should be brought to the governing body's attention, or a statement that there are no such circumstances. The auditors may also request an extraordinary general meeting of the governing body to consider the statement. These provisions are analogous to those in the Companies Acts. Any such statements should also be sent to the HEFCEAS without delay, by the institution or, if it fails to do so, by the outgoing auditors.

126. The governing body must inform the Council's Chief Auditor without delay of the removal or resignation of the auditors.

127. In deciding whether or not to accept the appointment, anyone proposing to take up the office of external auditor should obtain the institution's permission to communicate with the outgoing auditors. Outgoing auditors should also obtain permission from the institution to discuss its affairs freely with the proposed auditors, and should disclose all information required by the proposed auditors that is relevant to the appointment. These provisions are analogous to those in the Guide to Professional Ethics of the ICAEW.

Restriction of auditors' liability

128. Institutions must not agree to any restriction in liability in respect of the audit of their annual financial statements. This principle matches that of Section 310 of the Companies Act 1985, which prohibits any capping of the auditors' liability in respect of audit opinions given under the Act.

129. For other types of work performed by the external auditor, the provider may ask the institution to agree to a restriction in the auditors' liability arising from any default by the auditor. Normally, such liability should be without limit. However, institutions may negotiate a restriction in liability so long as the decision is made on an informed basis. The governing body, through the audit committee, should be notified of any liability restriction agreed. Further information on liability restriction is provided in paragraph 6 of Annex C to this Code.

HEFCE access to external auditors

130. The HEFCEAS may wish to meet with institutions' external auditors, particularly in connection with a visit to the institution by the HEFCEAS. The institution should not limit access in any way. Formal discussion should normally be arranged through the institution's designated officer or representative. The HEFCEAS will exchange letters where necessary with both parties to deal with confidentiality and the terms under which access is given.