

Supplement B

to Circular 04/07

Audit

Audit Code of Practice



Learning+Skills Council

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Annex A: Mandatory Audit Requirements on Further Education Colleges

1 This index references the mandatory requirements for further education (FE) colleges and their auditors, as set out in the Learning and Skills Council (LSC) Audit Code

of Practice (the code). Audit requirements of the articles of government and the financial memorandum are given in paragraphs 30 and 31 of the code.

Table 1: Mandatory requirements for FE colleges and their auditors.

| Section | paragraph number in the code (Supplement A) |
|----------------------------------|---|
| <i>Audit committee</i> | |
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**Table 1: Mandatory requirements for FE colleges and their auditors.
(continued)**

| Section | paragraph number in the code (Supplement A) |
|---|--|
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| Quality assurance | 65, 66 |
| Relationships with management, auditors and review bodies | 54 |
| Removal and resignation | 90 |
| Resources | 51 |
| Rotation of the head of the IAS | 85 |
| Staffing | 56 |
| Strategy | 57, 58 |
| Terms of reference | 49 |
| <i>Financial statements auditor</i> | |
| Access to financial statements auditors | 104 |
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| Appointment of financial statements auditors | 82, 83, 84 |
| Audit report | 69 |

**Table 1: Mandatory requirements for FE colleges and their auditors.
(continued)**

| Section | paragraph number in the code (Supplement A) |
|---|---|
| Compliance with the Combined Code on Corporate Governance | 69 |
| Due care and professional care | 91, 92 |
| Eligibility | 78 |
| Engagement letter | 70, 71 |
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| Funding audit arrangements | Annex F to Supplement B |
| Liability | 87, 89 |
| Regularity and propriety | 68 |
| Rotation of partner | 85 |
| <i>Funding auditor (where appointed)</i> | 80, Annex F to Supplement B |
| Information required by the LSC: The FE college must promptly send to the PFA Regional Audit Manager: | |
| Annual IAS report | 64 |
| Financial statements auditor's management letters | 77 |
| Funding audit management letter | Annex F to Supplement B |
| The FE college must report to the LSC's Chief Executive, without delay, serious weaknesses, significant frauds, major accounting and other control breakdowns | 100 |
| Where applicable, the FE college must inform the LSC Regional Audit Manager of: | |
| Details of a significant change of audit service provider | 86 |
| Disagreement over the level of internal audit resources | 51 |
| Gaps in the audit service | 82 |
| Resignation statements of auditors | 90 |
| <i>Where applicable, the financial statements auditors must inform the PFA regional audit manager of:</i> | |
| Qualifications in audit reports | 76 |

Annex B: Minimum Terms of Reference for a Further Education College Audit Committee

1 As a minimum, the terms of reference for an FE college audit committee must include the following responsibilities:

- to advise the governing body on the adequacy and effectiveness of the FE college's systems of internal control and its arrangements for risk management, control and governance processes, and securing economy, efficiency and effectiveness (value for money)
- to advise the governing body on the appointment, reappointment, dismissal and remuneration of the financial statements auditor and the internal audit service (IAS)
- to advise the governing body on the scope and objectives of the work of the IAS, the financial statements auditor and the funding auditor (where appointed)
- to ensure effective coordination between the IAS, the funding auditor (where appointed) and the financial statements auditor, including whether the work of the funding auditor should be relied upon for internal audit purposes
- to consider and advise the governing body on the audit strategy and annual internal audit plans for the IAS
- to advise the governing body on internal audit assignment reports and annual reports and on control issues included in the management letters of the financial statements auditor (including their work on regularity) and the funding auditor (where appointed), and management's responses to these
- to monitor, within an agreed timescale, the implementation of agreed recommendations relating to internal audit assignment reports, internal audit annual reports, the funding auditor's management letter and spot-check reports (where appropriate) and the financial statements auditor's management letter
- to consider and advise the governing body on relevant reports by the National Audit Office (NAO), the Learning and Skills Council (LSC) and other funding bodies, and, where appropriate, management's response to these
- to establish, in conjunction with FE college management, relevant annual performance measures and indicators, and to monitor the effectiveness of the IAS and financial statements auditor through these measures and indicators and to decide, based on this review, whether a competition for price and quality of the audit service is appropriate

- to produce an annual report for the governing body and accounting officer, which should include the committee's advice on the effectiveness of the FE college's risk management, control and governance processes, and any significant matters arising from the work of the IAS, the funding auditors (where appointed) and the financial statements auditor
- to ensure that all allegations of fraud and irregularity are properly followed up
- to be informed of all additional services undertaken by the IAS, the financial statements auditors and the funding auditors (where appointed).

2 If the governing body decides to approve the financial statements on the advice of either the audit committee or the audit committee and the finance committee, the following term of reference can be added:

- to recommend the annual financial statements to the governing body for approval.

Annex C: Business Areas for Inclusion in Internal Audit Strategic Plans

1 To assist audit committees and internal audit providers, the business areas set out below must, where applicable, be included as a minimum within FE colleges' internal audit plans.

To be included in annual plans:

- the operation of governance processes
- the operation of risk management processes.

To be included in strategic (that is, over a three- to five-year period) plans:

- long-term planning, including formulating bids for allocations from the LSC and non-LSC funding
- learner number systems and funding claims
- financial planning, budget-setting, monitoring and forecasting
- fundamental financial accounting and asset controls
- significant partnerships, including FE college subsidiary or associated companies, franchising, joint ventures and subcontracted direct learning provision
- procurement and payments
- capital project planning, management and evaluation

- security of the IT infrastructure and disaster recovery
- contractors of the FE college who provide any service that handles or processes FE college finances or FE college management information in any form
- personnel, the appointment and departure of staff and senior postholders who are full time or part time, the payment of salaries, wages and other staff payments.

Annex D: Minimum Terms of Reference for Further Education College Internal Audit Services

1 The internal audit service (IAS) is responsible for conducting an independent appraisal of all the FE college's activities, financial and otherwise. It should provide a service to the whole FE college, including the governing body and all levels of FE college management. It is not an extension of, nor a substitute for, good FE college management, although it can have a role in advising FE college management. The IAS is responsible for giving assurance to the FE college's governing body and principal on the adequacy and effectiveness of the FE college's risk management, control and governance processes. The IAS assists FE college management by evaluating and reporting to it the effectiveness of the controls for which it is responsible. This work contributes to the opinion that the IAS provides on risk management, control and governance processes. It remains the duty of FE college management, not the IAS, to operate adequate systems of risk management, control and governance. It is for FE college management to determine whether or not to accept audit recommendations and to recognize and accept the risks of not taking action.

Appointment

2 The IAS is appointed by the governing body for a term of [x] years commencing [xxxx]. This is subject to satisfactory annual performance evidenced by annual review by

the audit committee and recommendation to the governing body. Remuneration shall be fixed by the governing body on the advice of the audit committee.

Scope

3 All the FE college's activities, funded from whatever source, fall within the remit of the IAS. The IAS may consider the adequacy of controls necessary to secure propriety, economy, efficiency and effectiveness in all areas. It will seek to confirm that FE college management has taken the necessary steps to achieve these objectives and manage the associated risks. The scope of the IAS's work shall cover operational and FE college management controls and should not be restricted to the audit of systems and controls necessary to form an opinion on the financial statements. As a minimum, the scope of work shall cover the business areas set out in Annex C in Supplement B to the Audit Code of Practice. The IAS shall devote particular attention to any aspects of risk management, control and governance processes affected by material changes to the FE college's risk environment.

4 The systems of control subject to the IAS's work shall include those systems of control operated by:

- all FE college subsidiary or associated companies
- the FE college's partners in franchised learning provision

- joint ventures
- subcontracted direct learning providers
- contractors of the FE college who provide any service that handles or processes FE college finances or management information in any form.

5 It is not within the remit of the IAS to question the appropriateness of policy decisions. However, the IAS is required to examine the arrangements by which such decisions are made, monitored and reviewed.

6 [This paragraph should be inserted if the corporation agrees.] The IAS may also conduct any special reviews requested by the governing body, audit committee or principal, provided such reviews do not compromise the IAS's objectivity or independence, or the achievement of the approved audit plan.

Responsibilities

7 The head of the IAS is required to give an annual opinion to the governing body, through the audit committee, on the adequacy and effectiveness of the FE college's risk management, control and governance processes. He or she should also comment on other activities for which the governing body is responsible, and to which the IAS has access.

8 The IAS fulfils its terms of reference through review and evaluation of risk management, control and governance processes. These comprise the policies, procedures and operations in place to:

- establish and monitor the achievement of the FE college's objectives
- identify, assess and manage the risks to achieving the FE college's objectives
- advise on, formulate and evaluate policy, within the responsibilities of the principal as accounting officer
- ensure the economical, effective and efficient use of resources

- ensure compliance with established policies, procedures, laws and regulations
- safeguard the FE college's assets and interests from losses of all kinds, including those arising from fraud, irregularity and corruption
- ensure the integrity and reliability of information, accounts and data, including internal and external reporting and accountability processes.

Standards and Approach

9 The IAS's work will be performed with due professional care, in accordance with the requirements of the LSC as detailed in the LSC's Audit Code of Practice and the standards for the IAS promulgated by HM Treasury. The work shall comply in all material respects with Government Internal Audit Standards (GIAS). The IAS should also have regard to advice provided by professional auditing and accountancy bodies.

10 The head of the IAS shall implement measures to monitor the effectiveness of the service and compliance with standards. The head of the IAS should prepare a set of performance measures and criteria for the IAS function, which shall be agreed with the audit committee.

11 In achieving its objectives, the IAS shall develop and implement an audit strategy that assesses the FE college's risk management, control and governance processes.

Independence

12 The IAS has no executive role, nor does it have any responsibility for the development, implementation or operation of systems. However, it may provide independent and objective advice on risk management, control, governance processes and related matters, subject to resource constraints. For day-to-day administrative purposes only, the head of the

IAS reports to a senior officer within the FE college and the reporting arrangements must take account of the nature of audit work undertaken. The head of the IAS has a right of direct access to the chair of the governing body, the chair of the audit committee and the principal.

13 The audit committee shall advise the governing body on all matters concerning internal control. Within the FE college, responsibility for the FE college's risk management, control and governance processes rests with the governing body and management, who shall ensure that appropriate and adequate arrangements exist without relying on the FE college's IAS. To preserve the objectivity and impartiality of the IAS's professional judgement, responsibility for implementing audit recommendations rests with FE college management.

Access and Liaison

14 The FE college IAS shall have unrestricted access to all documents, records, assets, personnel and premises of the FE college and its companies, and to relevant documents of franchise providers, and be authorized to obtain such information and explanations as they consider necessary to form its opinion.

15 In turn, the IAS agrees to comply with any requests from the financial statements auditors, the LSC, the internal auditors of the Department for Education and Skills (DfES) and the National Audit Office (NAO) for access to any information, files or working papers obtained or prepared during audit work that they need to discharge their responsibilities. The LSC seeks to place reliance upon the work of the FE college's IAS. Liaison is necessary for the LSC to form this opinion and shall not give rise to additional fees.

16 The IAS shall liaise with the financial statements auditor, the funding auditor

(for those colleges not eligible for plan-led funding), and the LSC's Provider Financial Assurance (PFA) Service Centre to enhance the level of service it provides to the FE college management. The IAS and the audit committee may seek to place reasonable reliance on the work of the funding auditor (where appointed).

Reporting

17 The IAS shall prepare, before the beginning of the year, a long-term strategy document supported by an assessment of resource needs and an annual audit plan. These shall be submitted to the governing body for approval following consultation with relevant managers and the principal, and on the recommendation of the audit committee.

18 The IAS produces its reports in writing, usually within one month of completion of each audit, giving an opinion on the area reviewed and making recommendations where appropriate. Recommendations should be prioritized. All reports are provided to the principal and should be copied to the audit committee. Heads of department or services shall be required to respond to each audit report, usually within one month of issue. In their response, they should state, for agreed recommendations, their proposed action, the person responsible for implementation and a date by which action will be completed. Material recommendations will usually be followed up some 6 to 12 months later. In addition, the audit committee shall monitor the implementation of audit recommendations by FE college management.

19 The head of the IAS submits an annual report to the governing body and principal through the audit committee, based on the FE college's financial year. This gives an opinion on the adequacy and effectiveness of the FE college's risk management, control and governance processes and on the arrangements for securing economy, efficiency and effectiveness.

20 The IAS's annual report to the governing body includes:

- a statement of the overall adequacy and effectiveness of the FE college's risk management, control and governance processes
- any qualifications to that opinion, together with the reasons for the qualification
- a notice of any issues that the head of the IAS judges relevant to the preparation of the statement of the responsibilities of the members of the governing body, the corporate governance statement (that now incorporates the statement of internal financial control) and the statement on the system of internal financial control, such as an analysis of common or significant weaknesses or details of any major internal audit findings where action appears to be desirable but has not been taken
- a comparison of the IAS's activity during the year with that planned, placed in the context of the IAS need
- a summary of the performance of the IAS function against its performance measures and criteria
- comment on compliance with the GIAS
- the results of the IAS quality assurance programme.

21 The minimum content for an IAS's annual report is set out at Annex E to this supplement.

22 The head of the IAS reviews the annual report with the principal and audit committee prior to publication. A copy of the annual report is sent without delay to the local LSC's Regional Audit Manager by the FE college, after it has been received by the governing body on the advice of the audit committee. Copies of other reports and

responses to them should not routinely be sent to the LSC's Regional Audit Manager but the LSC's Regional Audit Manager may exceptionally request them.

23 The head of the IAS is accountable to the principal and the governing body through the audit committee for the performance of the service. The IAS also reports audit findings to the heads of department or services within the FE college. The head of the IAS shall keep the principal informed of audit results and draw the attention of the audit committee to significant findings and recommendations. This may be done by providing the audit committee with copies of all reports, or by reporting by exception, or by providing a summary of key issues.

Irregularities, Including Fraud and Corruption

24 The IAS shall without delay report to the LSC's Chief Executive, and copy to the Executive Director of the local LSC, serious weaknesses, significant fraud, major accounting and other breakdowns, subject to the requirements of the Proceeds of Crime Act 2003.

25 The head of the IAS shall be informed when evidence of potential irregularity, including fraud, corruption or any impropriety, is discovered so that he or she can consider the adequacy of the relevant controls, evaluate the implication of the fraud on the risk management, control and governance processes and consider making recommendations as appropriate. The role of the IAS is not to investigate the irregularity unless commissioned to do so.

Ownership of Papers

26 The IAS's papers are the property of the FE college. In the event of a change of the IAS provider, the outgoing IAS provider may, with the agreement of the FE college, surrender all

audit working papers which demonstrate compliance with the GIAS. Arrangements should be made for the outgoing IAS provider to meet the incoming IAS provider where appropriate.

27 [If the governing body agree that the working papers remain the property of the IAS provider, the wording of Appendix C of the Institute of Chartered Accountants in England and Wales Technical Release 2/98 *Access to the Working Papers of Internal and External Auditors of FE Colleges* should be followed. This is available at www.icaew.co.uk/viewer/index.cfm?AUB=TB2I_2122.]

Electronic Communication

28 During the engagement, the IAS and the FE college may from time to time communicate electronically with each other. However, the electronic transmission of information cannot be guaranteed to be secure or free of viruses or error and such information could arrive late or incomplete, be intercepted, corrupted, lost, destroyed, or otherwise be adversely affected or unsafe to use. No systems or procedures can guarantee that transmissions will be unaffected by such hazards.

29 The IAS and the FE college confirm that each accepts the risks of electronic communications between each other. Each agrees to use commercially reasonable procedures to check for the most commonly known viruses before sending information electronically. Each shall be responsible for protecting its own systems and interests in using electronic communications. The IAS and the FE college shall have no liability to each other on any basis, whether in contract, tort (including negligence) or otherwise, in respect of any error, damage, loss or omission arising from or in connection with the electronic communication of information between each other and the reliance on such information.

Termination of Appointment

30 The governing body may, by resolution, remove the FE college's IAS before its term of office expires, notwithstanding any agreement between the IAS and the FE college.

31 Where the IAS ceases to hold office for any reason, it shall provide the governing body with either a statement of any circumstances connected with the removal or resignation that it considers should be brought to the governing body's attention, or a statement that there are no such circumstances. The FE college must copy this statement to the LSC's Regional Audit Manager, without delay.

Limitation of Liability

32 For internal audit work, FE colleges can negotiate over any proposal by the IAS to restrict or cap their liability. The governing body must specifically consider and approve any request for a liability restriction. This limit must not be under £1 million for smaller FE colleges and more for larger FE colleges.

Annex E: Minimum Content for a Further Education College Internal Audit Annual Report

Introduction

1 My internal audit work for the period from 1 August 20[xx] to 31 July 20[xx] was carried out in accordance with the internal audit plan approved by the governing body. The plan was constructed in such a way as to allow me to make a statement of the adequacy and effectiveness of the college's risk management, control and governance processes.

Internal Audit Planned Coverage and Output

2 The governing body agreed to an input of [xx] days of internal audit coverage in the year.

3 The planned reviews approved by the governing body, the planned number of days and the actual time against plan are shown below. [Insert here a table showing the internal audit review, the type of review (that is, systems audit, compliance audit, controls self-assessment and so on), planned days, actual days and comments. The table should include any additional work carried out.]

Management Action on Recommendations

4 Management [have/have not] taken or planned appropriate and timely action to implement our recommendations.

(Management have not taken appropriate and timely action on the following significant recommendations.)

Operational Assurance

5 The IAS reviewed and evaluated the college's processes in a number of business areas: [Insert a list of the business areas audited in 20xx/xx and the process reviewed.]

6 From these examinations the IAS concluded that the policies, procedures and operations in place to:

- establish and monitor the achievement of the college objectives are [good/adequate/weak]
- identify, assess and manage the risks to achieving the college's objectives are [good/adequate/weak]
- advise on, formulate, and evaluate policy, within the responsibilities of the principal as accounting officer, are [good/adequate/weak]
- ensure economical and efficient use of resources are [good/adequate/weak]
- ensure compliance with the college's policies, procedures, laws and regulations are [good/adequate/weak]
- safeguard the college's assets and interest from losses of all kinds, including those from fraud, irregularity

and corruption, are [good/adequate/weak]

- ensure the integrity and reliability of information, accounts and data, including internal and external reporting and accountability processes, are [good/adequate/weak.]

- the outcomes of the IAS's quality assurance processes
- the results reported in the funding auditor's management letters (where appropriate).

Overall Assurance

7 As the head of internal audit of [name of college], I am required to provide the governing body and the principal with an opinion on the adequacy and effectiveness of the college's risk management, control and governance processes. In giving my opinion it should be noted that assurance can never be absolute. The most that the IAS can provide to the governing body is reasonable assurance that there are no major weaknesses in the college's risk management, control and governance processes. In assessing the level of assurance to be given, I have taken into account:

- all audits undertaken during [insert 20xx, the year reported upon]
- any follow-up action taken in respect of audits from previous periods
- any significant recommendations not accepted by management and the consequent risks
- the effects of any significant changes in the college's objectives or systems
- matters arising from previous reports to the governing body
- any limitations which may have been placed on the scope of internal audit
- the extent to which resource constraints may impinge on the head of the IAS's ability to meet the full audit needs of the college
- what proportion of the college's audit need has been covered to date

Opinion

8 I [am/am not] satisfied that sufficient internal audit work has been undertaken to allow me to draw a reasonable conclusion as to the adequacy and effectiveness of the college's risk management, control and governance processes. In my opinion [name of college] [has/does not have] adequate and effective management, control and governance processes to manage its achievement of the college's objectives.

Possible Qualifications

9 [These qualifications must only be used with an adverse opinion.] Where significant deficiencies in [risk management/control/governance] processes have been identified by either management or the IAS, I am satisfied that they have been resolved in an appropriate manner.

[or]

Where significant deficiencies in [risk management/control/governance] processes have been identified by either management or the IAS, I am satisfied that the actions the college's management plan to take will, if implemented satisfactorily, resolve the deficiencies in an appropriate manner.

[or]

This opinion is based upon my conclusion that significant deficiencies in [risk management/control/governance] processes have not been adequately resolved.

[or]

Restrictions to the audit programme prevent me from providing an opinion on the

adequacy and effectiveness of [risk management/control/governance] processes.

[or]

I have not completed sufficient work at the college to date to enable me to conclude whether [name of college] has adequate and effective [risk management/control/governance] processes.

Performance of the Internal Audit Service

10 Annual performance indicators set by the audit committee at the [summer/autumn] meeting are listed below.

11 [Insert a list of annual performance indicators compared with the actual performance of the IAS with explanatory comments as appropriate.]

12 The results of the internal audit quality assurance programme are set out below.

13 [Insert a brief description of the quality assurance programme and the main results.]

14 The IAS [has/has not] complied with the Government Internal Audit Standards (GIAS) and the requirements of the LSC's Audit Code of Practice. [The wording of the report need not be restricted to that shown. The head of the IAS may wish to expand the text, for example where there are areas of deficiency.]

Annex F: Funding Audit Arrangements for Colleges not Eligible for Plan-led Funding

Introduction

1 From 2004/05 onwards, the majority of FE colleges are eligible for plan-led funding. For those colleges which are not eligible for plan-led funding, there will continue to be a year-end reconciliation process and, where appropriate, clawback of unearned funds in relation to 2004/05 and future years when they remain ineligible for plan-led funding. This reconciliation will be calculated on the LSC's detailed funding methodology, as for 2003/04.

Appointment

2 For the years 2000/01 to 2003/04, the LSC has contracted with seven firms of auditors to undertake the audit of FE colleges' funding claims. For guidance relating to the funding audit work being carried out in respect of 2003/04, readers should refer to the Interim Audit Code of Practice.

3 As noted above, those colleges that are not eligible for plan-led funding for 2004/05 and subsequent years will still be subject to a funding audit in addition to the regularity audit. Funding auditors will be appointed by the LSC in the same way as for previous years. The funding audit approach under plan-led funding has not yet been finalized, but it is expected to mirror the approach used for 2003/04.

4 The LSC reserves the right to review the appointment of the funding auditors annually,

and reappointment will be subject to satisfactory performance. The duties of the funding auditor are clearly presented in a standard letter of engagement between the auditor and the LSC. The contracts are managed by the PFA Service Centre.

5 The planned cost of the funding audit is met by the LSC. Where the funding auditors encounter significant unforeseen problems attributable to FE colleges, the cost of significant over-runs will be borne by those FE colleges as per the arrangements for 2003/04. Before funding auditors incur such additional time, they must agree the nature and extent of any additional work with the local LSC and the FE college.

6 Under their contract with the LSC, funding auditors are permitted to perform only certain additional services at FE colleges that they audit. These will be set out when arrangements are finalized. Any doubt about the permissibility of services that are additional to the funding audit must be referred to one of the LSC's Regional Audit Managers, who will advise on what is acceptable.

Monitoring performance of funding auditors

7 The audit committee may wish to identify and approve annually appropriate performance indicators for the funding auditor, where appointed. The LSC is ultimately responsible for monitoring the performance of funding auditors.

FE college audit committees should oversee the audit of the FE college's funding claims and the submission of returns to the LSC. The LSC's Director of External Assurance will seek feedback from FE colleges and their audit committees on the performance of the funding auditors through client satisfaction surveys, which include standard questions set by the LSC.

Liaison between internal auditors and funding auditors

8 In colleges where a funding auditor is appointed, the LSC wishes to minimize duplication between the work of the FE college IAS and the LSC-appointed funding auditor. The funding auditor conducts extensive work on the learner number systems in undertaking the funding audit. The funding auditor will report the findings of his or her work in annual opinions and management letters to the FE college. The funding auditor's work is based upon standard LSC audit programmes at every FE college, which are available on the LSC website (www.lsc.gov.uk).

Quality assurance

9 The LSC will put in place quality assurance arrangements whereby the work undertaken by the LSC-appointed funding auditors is reviewed and assessed. The results of these reviews along with the use of standard audit programmes and operating guidance ensure that the funding auditor's work is carried out to an appropriate standard. The LSC will offer assurance on the FE college's learner number systems based on the results of these reviews. The FE college's IAS must review the findings set out in the funding auditor's interim opinion and management letter when considering the annual statement on the FE college's risk management, control and governance processes. The FE college's IAS and the audit committee must decide whether to place reasonable reliance on the work of the funding auditor or to conduct work themselves to derive assurance on the FE college's learner number system.

Audit Approach

10 The funding auditors will agree a formal, deliverable timetable with FE college management to ensure that the audit work is carried out to enable the meeting of deadlines for the submission of funding claims and related records and data returns. This timetable will need to take account of meetings of the governing body to approve the financial statements and also meetings of the audit committee to review the management letter and the finance or audit committee to consider the financial statements before recommending them to the governing body. Funding auditors will inform local LSCs of key audit milestones.

Reporting

11 In previous years, the funding auditor has formed interim and final opinions on the FE college's funding claims and related records and data returns. These opinions were copied to local LSCs and FE colleges.

12 From 2004/05 the timing and sequence of events may change. This is due to the use of the previous year's historical data for achievements, rather than waiting until December or January for the actual data. This may remove the requirement for an interim funding claim. Arrangements will be set out in a funding claims circular, or equivalent, for 2004/05.

13 At colleges not eligible for plan-led funding, the financial statements auditor must not sign off his or her audit report until a cash recovery and/or responsive growth statement or equivalent has been provided by the LSC confirming the FE college's funding and an assurance letter has been received from the Executive Director of the local LSC. Audit work on the financial statements must not be delayed until receipt of the cash recovery and/or responsive growth statement. To avoid delay, financial statements auditors must undertake their work on the basis of interim figures provided by the FE college.

14 The LSC will produce a model management letter in guidance that is issued from time to time. The format of the management letter will be standardized to aid consistency in reporting across the sector. The format of the management letter will be posted to the LSC website (www.lsc.gov.uk) in due course.

15 The LSC's funding auditors will promptly send a copy of their finalized management letters, including those arising from any interim audit, audit of the final funding claim and other reports of audit findings, to the FE college and to the LSC's Regional Audit Manager. The list of Regional Audit Managers and their contact details are published on the LSC website (www.lsc.gov.uk/National/Documents/SubjectListing/FundingLearning/ProviderFinance/ProviderFinancialAssurance/Contactdetails.htm).

16 Where the provider has subcontracted, franchised or partnership learning provision, the funding auditor will perform spot-check visits, in accordance with a standard matrix set out by the LSC. This will result in a separate letter that will be prepared in accordance with a model format provided by the LSC for funding auditors to use. The format of this management letter will be posted on the LSC website in due course. As with the management letter, issues arising from the spot-check visits must, in the first instance, be discussed with the FE college.

17 Although there is no contractual relationship between the FE college and the funding auditor, the LSC will require its contractors to liaise with and report to FE college audit committees. Under the terms of the funding audit contract, the funding auditor will attend FE college audit committee meetings to present the management letter prior to its submission to the LSC.

Annex G: Accountability of Local Authorities and the Role of the Audit Commission

Overarching Accountability Requirements on Local Authorities

1 As a body responsible for the conduct of public business and for spending public money, local authorities are accountable for ensuring both that public business is conducted within the law and to proper standards, and that public money is safeguarded, properly accounted for and used economically, efficiently and effectively. In discharging this duty, authorities and their management (both members and officers) are responsible for putting in place:

- proper arrangements for the governance of their affairs and the stewardship of the resources at their disposal
- adequate and effective systems of internal control, including financial monitoring and reporting arrangements.

2 Under the Audit Commission's (the Commission's) Code of Audit Practice, auditors appointed by the Commission give an independent opinion on local authorities' financial statements and may review, and report on, aspects of the arrangements put in place to ensure the proper conduct of their financial affairs and to manage their performance and use of resources. Under section 28 of the Audit Commission Act 1998,

the Commission will also arrange to certify claims or returns in respect of grants or subsidies paid to the local authority.

3 Local authorities must satisfy themselves that they will be able to comply with the terms and conditions of the LSC's funding before accepting it. They must establish effective administrative and financial systems for each of the LSC's funding streams, and these systems must include adequate and effective internal controls and proper arrangements to prevent and detect fraud. The accounting records for the LSC's funds must be sufficient to show all of the authority's transactions, and be kept up to date and maintained in accordance with proper practices.

4 Local authorities are responsible for the proper, accurate and timely preparation of the claims and returns required by the LSC. Claims and returns must be completed in accordance with the terms and conditions of the LSC's schemes. Their preparation should be adequately supervised and reviewed before the certificate required from the local authority's Chief Finance Officer is given, so that the Chief Finance Officer may be satisfied with the entries made and that the assurance given by his or her certificate is well founded. Claims and returns must be supported by adequate working papers (including, where applicable, non-financial records) that:

- satisfy the statutory requirement on the Chief Finance Officer (under

Regulation 5, Accounts and Audit Regulations 2003, SI 2003/533) to maintain adequate records in relation to claims

- document the basis of the claim or return and the derivation of the information it contains
- are kept in a form that will help the auditor and reduce certification time (and, therefore, the cost to the authority).

Certification by Auditors Appointed by the Audit Commission

5 Currently the LSC seeks assurance from auditors appointed by the Audit Commission on its adult and community learning (ACL) and FE funding. The Audit Commission has a statutory responsibility to make arrangements for the certification of grant claims and returns, including those which the LSC requires for its funding. Local authorities are responsible for ensuring that only the auditor appointed to them by the Audit Commission certifies claims and returns for the LSC's funding.

6 Certification work is not covered by the Commission's Code of Audit Practice as the Commission, rather than its appointed auditors, has responsibility for making certification arrangements. Appointed auditors are required to comply with:

- the Commission's general certification instruction (CI A01) for claims and returns
- the specific instructions issued by the Commission for the LSC's funding streams, which are developed in consultation with the LSC.

7 Where appropriate for certification purposes, auditors should consider whether

reliance can be placed on their other work (on systems, final accounts, or fraud and corruption) carried out during their audit of the authority's financial statements.

8 Occasions arise when claims or returns include entries for which another body holds the only supporting information. This is an increasingly common situation with contracted-out tuition and other operations and where partnership arrangements mean the authority submits a claim or return based on the transactions of its partners. In these circumstances, in order to complete and certify the claim, the local authority will need assurance that the transactions included in its claims are eligible for grant. The local authority might obtain such assurance, for example, by obtaining independently certified statements for each contracted-out procedure or partner (in sufficient detail to support the eligibility of transactions in its claim) or by undertaking spot-checks for monitoring purposes. Auditors are not normally expected to visit third parties in cases where insufficient information is held by the authority to support claim form entries and will instead issue a qualification letter to the LSC setting out the facts.

Annex H: Definition of Key Terms

| Term | Definition |
|------------------------------|--|
| ACL | See adult and community learning |
| adult and community learning | The LSC grants funds to local education authorities (LEAs) for the delivery of adult and community learning in accordance with each LEA's adult learning plans. A funding agreement, signed by both parties, records the agreement regarding the amount of funding to be paid in support of the LEA's adult learning plan agreed with the LSC. |
| DfEE | Department for Education and Employment (now the Department for Education and Skills) |
| DfES | The Department for Education and Skills (formerly the Department for Education and Employment) |
| FE college | Further education (FE) college. FE colleges are those incorporated under the Further and Higher Education Act 1992 or funded under the financial memorandum set out in Further Education Funding Council (FEFC) Circular 99/48. |
| financial memorandum | A memorandum that sets out the terms and conditions of the agreement under which the LSC provides grant-in-aid to FE colleges and dance and drama schools. It provides information on the framework of relationships between FE colleges and the LSC. The financial memorandum is set out in FEFC Circular 99/48. |

| Term | Definition |
|------------------------------|--|
| financial statements auditor | <p>The financial statements audit of a college may be undertaken by:</p> <p>a those accountants who are both registered to audit limited companies in accordance with Part II of the Companies Act 1989 and who are members of one of the following professional accountancy bodies:</p> <ul style="list-style-type: none"> • Institute of Chartered Accountants in England and Wales • Institute of Chartered Accountants of Scotland • Institute of Chartered Accountants in Ireland • Chartered Association of Certified Accountants • Association of Authorised Public Accountants <p>or</p> <p>b partners in public practice who are members of the Chartered Institute of Public Finance and Accountancy.</p> <p>The Audit Commission may also carry out audits of financial statements for local authorities and the National Health Service (NHS) in England and Wales.</p> |
| funding agreement | <p>The LSC's funding agreements are its formal terms and conditions for providing funding to FE colleges and other providers. These funding agreements may take the form of a financial memorandum (or part thereof) for grant-in-aid funding, a grant letter or a contract.</p> |

| Term | Definition |
|-------------------------------------|--|
| funding auditor | The auditor responsible for the audit of LSC funding streams. At FE colleges, the LSC has appointed firms to undertake the audit of college's Individualized Learner Record (ILR) data and final funding claims based upon this data and any claims for LSC funding of the college within the scope of their work. |
| <i>Government Accounting</i> | HM Treasury guide published by HMSO as <i>Government Accounting: A Guide on Accounting and Financial Procedures for the Use of Government Departments</i> |
| GIAS | See Government Internal Audit Standards |
| Government Internal Audit Standards | The LSC specifies in the code that the operation and conduct of the college IAS must comply with the standards of internal audit promulgated by HM Treasury. These standards are known as the Government Internal Audit Standards (GIAS) issued in July 2001. A copy of the GIAS is available online (www.hm-treasury.gov.uk). |
| IAS | See internal audit |
| ILR | Individualized Learner Record. The ILR replaced the Individualised Student Record (ISR) for 2002/03 as the records FE colleges and other providers are required to keep as the basis for their funding claims and other statistical and information returns to the LSC and other interested parties. |

| Term | Definition |
|-----------------------------------|---|
| internal audit | <p>Internal audit is defined in the GIAS as being “an independent and objective appraisal service within an organization”.</p> <p>Each college governing body must appoint an internal audit service (IAS). It must be separate from college management, even if provided in-house, and without any executive, management or operational responsibilities outside internal audit.</p> <p>It is not permissible for FE colleges to appoint as internal auditors the same firm that undertakes the financial statements audit or the contractors appointed by the LSC to undertake the funding audit.</p> |
| learner number systems | <p>The systems kept by providers to record details of learners. A key element of the learner number systems will be the ILR.</p> |
| PFA | provider financial assurance |
| regularity audit | <p>An audit of the regularity and propriety of a college’s spending, performed by the college’s financial statements auditor.</p> |
| specialist designated institution | <p>A publicly funded FE institution that is incorporated as a limited company</p> |
| work-based learning | <p>Work-based learning refers to a collective group of learning programmes delivered in a work or work-related setting.</p> |

Notes

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