

# **Audit Code of Practice**

**May 1998**

# Contents

	<i>Paragraph</i>
<b>Introduction</b>	<b>1</b>
<b>Code in Context</b>	<b>6</b>
Need for an audit code of practice	6
Scope	7
Observance	11
Applicability	13
Updating	16
<b>Accountability of Further Education Colleges</b>	<b>18</b>
Parliament	20
Department for Education and Employment	22
Council	25
Colleges	28
<b>College Audit Committee</b>	<b>31</b>
Role	34
Membership	35
<b>Internal Audit Service</b>	<b>37</b>
Role	38
Standards	40
Scope	41
Planning	42
Reporting	44
Access	46
Council access	48



<b>College External Auditor</b>	<b>49</b>
Role	49
Eligibility	52
Council access	53

<b>Areas Common to the College Internal Audit Service and External Auditor</b>	<b>54</b>
Selection criteria and procedures	54
Auditors' liability	58
Due professional care	60
Access	61
Removal or resignation of auditors	62
Additional services	63

<b>Fraud and Irregularity</b>	<b>64</b>
-------------------------------	-----------

<b>Guidance Notes and Self-assessment</b>	<b>69</b>
---	-----------

Annex A	Mandatory Audit Requirements
Annex B	HM Treasury Internal Audit Standards
Index	



---

# Audit Code of Practice

## Introduction

- 1 This audit code of practice is for the use of:
- governing bodies, their subcommittees and the managers of colleges, in complying with the Council's requirements for audit
  - internal audit services at colleges, which operate as a service to management and to the organisation by measuring and evaluating the effectiveness of the whole system of internal control. The internal audit services are required by governing bodies, under the terms of their engagement, to comply with the code
  - external auditors at colleges, which are also required to comply with the code, under their terms of engagement
  - those outside the sector, to help them understand the strength of the audit framework within which colleges operate.

2 The code is supplemented by four guidance notes which offer current good practice in internal and external audit and colleges' governance and management of the auditing process. They give more detailed guidance and models which the users of the code may wish to adopt.

3 The requirements of the code are given in the following sections:

- the code in context and how colleges may self-assess their audit arrangements (paragraphs 6 to 17)
- an overview of accountability of further education colleges (paragraphs 18 to 30)
- the college audit committee (paragraphs 31 to 36)
- the college internal audit service (paragraphs 37 to 48)
- the college external auditor (paragraphs 49 to 53)
- areas common to the college internal audit service and external auditor (paragraphs 54 to 63)

- fraud and irregularity (paragraphs 64 to 68)
- guidance notes and self-assessment (paragraphs 69 to 72).

4 The guidance notes cover:

- the college audit committee (supplement A)
- the college internal audit service (supplement B)
- the college external auditor (supplement C)
- areas common to the college internal audit service and external auditor (supplement D).

5 This code and the related guidance notes supersede Circular 92/07 and Circular 92/12 and will come into effect on 1 August 1998. At the time of writing there are three areas which have not been finalised, namely access to auditors' working papers, limitation of auditors' liability, and the required assurance on the system of internal control which is given by the internal audit service. Colleges and auditors should comply with the code as it stands until further guidance is issued.

## Code in Context

### Need for an Audit Code of Practice

6 The financial memorandum between the Further Education Funding Council (the Council) and the Department for Education and Employment (DfEE) requires the Council to issue an audit code of practice (the code). In turn, the Council, through its financial memorandum with colleges, has required colleges to put in place audit arrangements. These arrangements concern:

- appointment of an internal audit service by colleges
- the terms of reference and scope of the internal audit service in colleges and circulation of their reports
- the establishment of audit committees by colleges
- the provision of internal and external audit in accordance with guidance from the Council, embodied in this code.

---

## Scope

- 7 The code is not intended to cover:
- the inspection of colleges by the Council
  - those audit arrangements that are put in place to meet the objectives solely of bodies other than the Council.
- 8 These other audit arrangements might be:
- an audit to narrowly focused financial objectives, for example the work of the Inland Revenue, Customs and Excise or the European Court of Auditors
  - other review or audit bodies which might be principal contractors with colleges, for example training and enterprise councils (TECs), the Higher Education Funding Council for England (HEFCE) or the Home Office.
- 9 The Council, in conjunction with the National Audit Office (NAO), seeks, and will continue to seek, a rationalisation of the work of these other bodies. Due to their number, variety and distance from the Council, it has to date proved impracticable to bring their arrangements within the code.
- 10 The code includes a brief description of the work of the comptroller and auditor general (C&AG), the head of the NAO, as this work is an important part of the accountability framework within which colleges operate.

## Observance

- 11 The term 'must' indicates mandatory requirements, which are included in the code, which must be observed by colleges. All mandatory requirements are summarised at annex A to this code.
- 12 The guidance notes are intended to assist colleges and their auditors in complying with the mandatory requirements. In its appraisal of a college's audit arrangements, the Council will look for compliance with the mandatory requirements set out in annex A, as well as good practice as detailed in the guidance notes.

## Applicability

- 13 The code is designed to be read in conjunction with the relevant standards underlying them. These are:

- auditing standards issued by the Auditing Practices Board in relation to external audit
- the *Government Internal Audit Manual* (GIAM) in relation to internal audit
- guidance on internal audit issued by the Auditing Practices Board.

14 More detailed advice on any aspect of the code is available from the Council's audit service via regional offices.

15 The code is not intended to be a manual. Colleges and audit providers should develop their own management procedures and manuals appropriate for them, taking account of this code.

## Updating

16 It will be necessary from time to time for the code to be updated. The Council intends to keep the operation of the code under review and will consult interested parties before making any significant amendments. Amendments will be made to the code as soon as the three unfinalised matters noted in paragraph 5 have been resolved. All amendments will be announced in circulars supplementary to the code and guidance notes. The Council's audit service welcomes comments made to the chief auditor on the code and its operation at any time.

17 A full review of the code will be undertaken by the Council following the end of the Council's current audit cycle. This cycle ends on 31 July 2001.

## Accountability of Further Education Colleges

18 Colleges within the further education sector are accountable to a wide range of bodies. In addition to the Council, most colleges are accountable to bodies such as the HEFCE, TECs, local authorities and private sector organisations. This accountability may be for a variety of reasons other than the purely financial. The code is concerned with colleges' accountability for the safeguarding and use of public funds, through the colleges' systems of internal controls.

19 Other bodies considered in the code also have a formal interest in colleges' receipt of these funds through the Council. These are parliament, the DfEE and the Council itself. Each of these bodies has made arrangements to safeguard its interest. The

---

financial memorandum between colleges and the Council states that the governing body is responsible for ensuring that funds are used only in accordance with the *Further and Higher Education Act 1992* (the Act), that memorandum, and any other conditions which the Council may from time to time prescribe. It is also in each college's own interest, as part of its management, to have in place a sound system of internal control (defined at appendix 1 of supplement B) that delivers the college's objectives at all levels. Since colleges receive public funds, they are subject to requirements in relation to the safeguarding and use of these funds.

### **Parliament**

20 Parliament's interest is to see that public funds are properly accounted for and used economically, efficiently and effectively by recipients. The C&AG is appointed by the Crown, and is an officer of the House of Commons. As auditor general, he carries out, on behalf of the House of Commons, the audit of the Council's accounts. He may, at his discretion, carry out examinations of the economy, efficiency and effectiveness with which the Council or colleges have used their resources in discharging their functions.

21 The C&AG has access to the accounts of colleges under section 53 of the Act. This may include all documents held by colleges that receive funding from the Council. Section 53 also refers to the examinations of economy, efficiency and effectiveness which the C&AG has powers to undertake under the *National Audit Act 1983*. The NAO carries out the audits and other examinations that discharge the responsibilities of the C&AG. The NAO is highly selective in its use of inspection rights — most of the financial audit work can be undertaken at the Council and investigations into economy, efficiency and effectiveness normally involve only a sample of colleges at any one time. Currently the NAO's visits to colleges are performed every other year.

### **Department for Education and Employment**

22 The funds distributed by the Council to colleges are first received from the DfEE. The permanent secretary of the DfEE is the principal accounting officer of the DfEE and is responsible, and accountable, to parliament for the issue of grant to the Council. Under the terms of the financial

memorandum between the Council and the DfEE, the principal accounting officer has formally designated the chief executive of the Council as accounting officer of the Council.

23 As the Council's accounting officer, it is part of the chief executive's duty to satisfy himself that institutions which receive Council funds have appropriate arrangements for financial management and accounting. One means of this is by securing for the Council an (internal) audit service. The work of the Council's audit service is examined by the DfEE's internal auditors and the NAO to ensure that audit standards and coverage are being achieved. This may include, from time to time, observation by DfEE auditors of the Council's audit service at work in colleges.

24 The DfEE has funding relationships with colleges other than funds distributed by the Council. These are primarily through TECs and the European social fund (ESF). Any of these funding relationships may be subject to audit arrangements, required by the DfEE, independently of the Council.

### **Council**

25 Funds are paid by the Council to colleges pursuant to section 5 of the Act to meet expenditure eligible for funding under that section, and must be used in accordance with the purposes for which they are granted. The Council itself is accountable for these public funds it disburses. As detailed in the financial memorandum between the DfEE and the Council, as accounting officer for the Council, the chief executive is responsible and accountable to parliament for:

- ensuring that the uses to which the Council puts funds received from the secretary of state for education and employment are consistent with the purposes for which the funds were given and comply with the conditions attached to them
- the regularity and propriety of expenditure from these funds and for securing the best possible economy, efficiency and effectiveness from them.

26 In turn, colleges are accountable to the Council under the financial memorandum for the public funds they receive from the Council. The funds are subject to such terms and conditions as the Council



---

may from time to time prescribe, subject to the provisions of the Act. These conditions are mainly given in the financial memorandum.

27 The financial memorandum with each college requires the appointment by governing bodies of an audit committee and an internal audit service ('internal audit' is defined in appendix 1 to supplement B). Colleges' instruments of government require governing bodies to appoint an external auditor. The Council's audit service assesses the adequacy and effectiveness of the system of internal control at colleges by performing reviews of colleges' governance and management arrangements. It aims to minimise duplication of audit effort by seeking to rely upon the work of colleges' internal audit services. It also evaluates the effectiveness of the operation of college audit committees. Such assessments will have regard to this code and any other guidance issued by the Council. The Council has also established an audit committee, which advises the chief executive on the work of the audit service and on the Council's control systems under the financial memorandum between the Council and the DfEE.

## Colleges

28 Within each college, the responsibilities set out in the financial memorandum are with the governing body and the principal. The governing body of each college must ensure that there is a sound system of internal control within the college. It is responsible for:

- ensuring that the financial, planning and other management controls, including controls against fraud and theft, applied by the college are appropriate and sufficient to safeguard public funds
- securing the economical, efficient and effective management of all of the college's resources and expenditure, capital assets and equipment, and personnel so that risk to public funds invested in the college by the Council is minimised.

29 The public nature of the governing body's role, its financial accountability through the Council to parliament, its stewardship of public funds, and not least the good name of the college and the interests of its students, all demand high standards of conduct in the exercise of its functions. The existence of a rigorous framework of audit and internal controls can assist governors in this process.

30 The principal is personally responsible for ensuring the proper and effective operation of these controls and may be required to appear before the Committee of Public Accounts of the House of Commons (PAC), alongside the chief executive of the Council, on matters relating to the funds paid by the Council to the college.

## College Audit Committee

31 The college's governing body must ensure that its responsibilities for proper financial management, for the effectiveness of the whole system of internal control and management systems and for the economy, efficiency and effectiveness of the college's activities have been properly discharged. To enable its responsibilities to be met, the financial memorandum between the college and the Council requires that the governing body of each college must establish an audit committee. An effective audit committee with sufficient authority and expertise can provide the governing body with authoritative advice on matters related to audit and internal control. Objectivity and independence is essential for the successful operation of the audit committee. The audit committee must adopt an advisory role and examine the college's systems of internal control through the work of the college's internal audit service and its external auditor.

32 The audit committee must be properly constituted by the governing body and given sufficient authority in its relationships with the governing body, college governors and management. It must have the right of access to obtain all the information it considers necessary from members of the college staff and governors, and to consult the internal audit service and external auditor directly.

33 Good practice and further guidance is included in supplement A, the guidance note on the college audit committee.

## Role

34 To establish the role of the audit committee, the governing body must set terms of reference for the audit committee. Model terms of reference are detailed in paragraph 2 of supplement A. The governing body must not add to these terms of reference responsibilities that require the audit committee to adopt an executive role, or its members to offer professional advice to the governing body outside their role as governors.

---

## Membership

35 The audit committee must consist of at least three members, with at least one having relevant skills and experience. In order to ensure independence and objectivity, members of the audit committee must not have executive authority in the college, nor be members of the college's finance committee or equivalent. Further guidance on membership of the audit committee is included at paragraphs 13 to 17 of supplement A.

36 The governing body must determine the membership of the audit committee and the terms on which they are to hold and vacate office.

## Internal Audit Service

37 Colleges receive substantial public funds and it is a condition of funding that a sound system of internal control over the use of these funds is in place and maintained at each college. Each governing body must, in accordance with the financial memorandum with the Council, appoint an internal audit service in accordance with guidance from the Council. It must be distinct from the external auditor and separate from college management, even if provided in-house, and without any executive, management or operational responsibilities outside internal audit.

### Role

38 Internal audit is defined in GIAM as being an independent appraisal function within an organisation which operates as a service to management and to the organisation by measuring and evaluating the effectiveness of the whole system of internal control. The primary responsibility of the college internal audit service is to provide assurance ('assurance' is defined at appendix 1 to supplement B) on the adequacy and effectiveness of the whole system of internal control at the college. The introduction and maintenance of internal control procedures and techniques in colleges is a management function.

39 Parts of the code are common to internal audit services and external auditors at colleges. These parts are dealt with at paragraphs 54 to 68 of this code. Good practice and further guidance is included in supplement B.

## Standards

40 The operation and conduct of the college internal audit service must comply with the standards of internal audit which have been promulgated by HM Treasury and included in GIAM. These standards are attached at annex B, and the major requirements are detailed below in paragraphs 41 to 45.

### Scope

41 The work of the college internal audit service must include the whole system of internal control of the college including all its operations, resources, personnel, services and responsibilities to other bodies. It must cover all activities associated with the college, including activities delivered by college companies or joint ventures or through collaborative provision, and be extended to those that are not funded by the Council.

### Planning

42 The college must receive from its internal audit service timely strategic and annual plans formulated according to the service's own priorities. The plans must be approved by the governing body on the recommendation of the audit committee, at the start of the year to which they relate, and in any event, before commencement of work.

43 Each college must devote sufficient resources to internal audit, having regard to the advice given by the head of internal audit. Where existing resources are inadequate to meet the need identified, the college internal audit service must draw this fact to the attention of college management and the governing body through the audit committee. Where agreement cannot be reached on the level of internal audit resources, the college must report this to the Council's chief auditor.

### Reporting

44 The internal audit service must produce an annual report on the adequacy and effectiveness of operation of the whole system of internal control of the college. *The level of assurance required of internal auditors is still unresolved.*

45 Each college's internal audit annual report must be received and be available to the governing body before the responsibility statement, contained within the college's annual financial statements, is signed.

---

## Access

46 The head of internal audit must have direct access to the principal and to the governing body, normally through the chairman of the audit committee.

47 The internal audit service must have unrestricted access to all documents, records, assets, personnel and premises of the college, its companies and to relevant documents of outward collaborators, and be authorised to obtain such information and explanations as considered necessary by the college internal audit service.

## Council Access

48 Colleges must, through their contract with the internal audit provider, allow the Council unrestricted access to all records, information and assets which the Council considers necessary to fulfil its responsibilities, including internal audit working papers which should be the property of the college, and key internal audit service personnel. *The arrangements relating to access to working papers have not yet been finalised.*

## College External Auditor

### Role

49 The basic objective of the college external auditor is to report on the truth and fairness of the income and expenditure for the year, and the financial position of the college and any subsidiary companies shown in the financial statements. The *Companies Act 1985* also requires the external auditor of limited companies to form an opinion as to whether proper accounting records have been kept, whether the accounts are in agreement with those records, and to state that the accounts comply with the disclosure requirements of the *Companies Act 1985*. The external auditor must also be concerned with the requirements of the Council to report on:

- the regularity of transactions, that is, that any terms and conditions attached to the funds provided to colleges have been complied with
- the accuracy of certain statistical returns.

50 The college external auditor must promptly send a copy of its finalised management letters, including those arising from any interim audit, audit

of final funding unit claim and other reports of audit findings to the Council's chief auditor, at the same time as the original goes to the college.

51 The Council may from time to time require external audit reports on other returns by colleges, for example on cashflow forecasts or recovery plans. Also, the role of the college external auditor may in future be extended to reporting on the results of audit of certain performance indicators.

### Eligibility

52 The criteria required for eligibility as external auditors of further education corporations are set out in schedule 8 of the Act. The external audit of a college may be undertaken by:

- a. those accountants who are both members of one of the following professional accountancy bodies:
  - i. Institute of Chartered Accountants in England and Wales (ICAEW)
  - ii. Institute of Chartered Accountants of Scotland
  - iii. Institute of Chartered Accountants in Ireland
  - iv. Chartered Association of Certified Accountants
  - v. Association of Authorised Public Accountants

and who are registered to audit limited companies in accordance with part II of the *Companies Act 1989*;

*or*

- b. partners in public practice who are members of the Chartered Institute of Public Finance and Accountancy.

External audit may also be carried out by the Audit Commission for Local Authorities and the National Health Service in England and Wales.

### Council Access

53 On occasion, the Council's audit service and the NAO may wish to meet with the college's external auditor. Access should not be limited in any way by the college, but the college's management will be notified in advance. The Council's audit service and the NAO must have access to all records, information and assets which it considers necessary to fulfil its

---

responsibilities, including external auditors' working papers and personnel. The college external auditor must comply with any requests from the Council's audit service and the NAO for access to any such information, obtained or prepared during the course of its audit. The Council has begun to review the work performed by external auditors in auditing final funding unit claims and a programme of reviews, based on a sample of colleges each year, is being introduced. *As previously noted at paragraph 48, the requirements relating to access to the working papers of the external auditor are not yet finalised.*

## **Areas Common to the College Internal Audit Service and External Auditor**

### **Selection Criteria and Procedures**

54 On joining the further education sector, or when mergers occur, colleges must have in place an internal audit service and external auditor with effect from the first day of operation of their financial memorandum with the Council. Colleges already in the sector have in place both sets of auditors, and will periodically seek to confirm or change their service providers. If the provider is changed, the contract with the incoming provider must start on the day after expiry of the contract with the outgoing provider to ensure continuity of provision. Where continuity is not possible, for example, due to the immediate resignation of the incumbent auditors, the college should institute interim arrangements before commencing the formal appointment process. One means of this might be by contracting with the college's external auditor to provide also an internal audit service in the short term. Such a period should not normally exceed three months. If the college believes that a gap is unavoidable, they should contact the Council's chief auditor.

55 The selection of the internal audit service at a college is subject to the same procedures as the selection of an external auditor. Colleges must hold a competition for both quality and price at least every five years or when the internal audit service provider or external auditor undergoes a significant change which affects the provision of the service. This may occur when there is a merger, demerger, takeover or other significant reorganisation. A new competition must also be held where the college undergoes a merger. The form of competition will depend on the

college's own financial regulations for placing contracts. These regulations may require full tendering or a more limited competition, depending on the value of the contract. If colleges are in any doubt as to what constitutes a significant change in audit provision, they should contact the Council's audit service.

56 The college must consult the Council's audit service on its shortlist of providers tendering for either, or both, the internal audit service and external audit. The college must send copies of the audit proposals to the Council, to assist in the consultation process.

57 Further guidance on the selection of an internal audit service and external auditor is given at the appendix to supplement D, the guidance note on areas common to the college internal audit service and external auditor.

### **Auditors' Liability**

58 Colleges must not appoint an external auditor whose letter of engagement includes any limitation of liability in respect of external audit 'certification' work. This includes the work performed on the final funding unit claim. The limitation might be through an explicit clause or by other limitation of liability. *As previously noted at paragraph 5, the requirements relating to the limitation of liability of auditors are not yet finalised.*

59 For categories of work other than external audit work, colleges are not prevented from negotiating with firms over any proposal by them to restrict or cap their liability as long as the eventual outcome represents the best value for money and takes into account the wider interests of the college, the Council, the DfEE and taxpayers. It should also take into account the risks and likely consequences of any loss suffered as a result of negligence, the effect of the terms of any restriction of liability (for example, are there overall financial limits or are certain risks excluded altogether irrespective of the degree of financial loss?); and the level of professional indemnity held. Value for money will probably mean a substantially lower price, but a firm may offer other benefits such as greater use of more experienced staff. The governing body must specifically consider and approve any request for a liability restriction. Further guidance is given in supplement D.

---

## Due Professional Care

60 Auditors must exercise both due care and professional care in their work, but the concepts can be explained separately. 'Due care' means working with competence and diligence, not infallibility or extraordinary performance. Auditors are not expected to give absolute assurance. 'Professional care' means using audit skills and judgement based upon appropriate experience, training, ability, integrity and objectivity. 'Professional care' should be appropriate to the objectives, complexity and materiality of the audit being performed.

## Access

61 Each college must grant both the head of internal audit and the external auditor the right of access to the chairman of the audit committee and also the right to ask the chairman to convene a meeting, if necessary with, or without, other participants.

## Removal or Resignation of Auditors

62 The college must inform the Council's chief auditor, without delay, of the removal or resignation of the internal audit service or the external auditor, and the circumstances surrounding this. Where the internal audit service or the external auditor cease to hold office for any reason, they must provide the governing body with either a statement of any circumstances connected with the removal or resignation, which they consider should be brought to the governing body's attention, or a statement that there are no such circumstances.

## Additional Services

63 Whether the college internal audit service and external auditor provide additional services beyond the scope of their audits is for the governing body to determine, although this responsibility may be delegated. If the college internal audit service or external auditor are called upon to carry out specific investigations and additional work, whether audit or otherwise, the governors and the auditors must ensure that such reviews do not compromise the auditors' objectivity, independence or achievement of audit plans.

## Fraud and Irregularity

64 The financial memorandum between the college and the Council states that the governing body is responsible for ensuring (that is, must) that the financial, planning and other management controls, including controls against fraud and theft, applied by the college, are appropriate and sufficient to safeguard public funds. The college external auditor has a duty to plan and conduct the audit so that there is a reasonable expectation of detecting material mis-statements in the accounts arising from irregularities, including fraud, or breaches of regulations. The college external auditor does not have a duty to search specifically for irregularities and fraud and their audit should not be relied upon to disclose them. Where the external auditor identifies a serious weakness or an accounting or other control breakdown it must be reported to the principal, the chairman of the governing body and the chairman of the audit committee without delay.

65 Colleges must have a written policy on the process to be followed when evidence of potential irregularity, including fraud, corruption, or any impropriety, is discovered. The policy should include referral to the audit committee and the commissioning by the audit committee of special investigations by the internal audit service or others. This may be set out in the college's financial regulations or specified separately in a 'fraud policy statement' (paragraph 26 of supplement A).

66 The head of internal audit must issue written procedures to auditors on the action to be taken if they suspect or discover fraud or irregularity and should make appropriate arrangements to be informed by the college, as soon as possible, of all suspected or discovered fraud, whether internal or external. The principal and chairman of the audit committee should also be informed.

67 Where the audit committee feels there is evidence of irregularity, fraud, corruption, or any impropriety, the chairman of the committee must notify the principal and the chairman of the governing body, who should raise the matter at the next meeting of the governing body. Where the matter is considered significant, the governors should consider holding a special meeting.

68 The college, its internal audit service and, where appropriate, its external auditor must report to the Council's chief executive, copied to the chief auditor, without delay, serious weaknesses,

---

significant frauds, major accounting and other control breakdowns of which they are aware. A serious weakness would be one which may result in a significant fraud or irregularity, and may include cases of irregularities in expenditure which could lead to suspicions of fraud. Significant fraud is usually where one or more of the following factors are involved:

- the sums of money are in excess of £10,000
- the particulars of the fraud are novel, unusual or complex
- there is likely to be great public interest because of the nature of the fraud or the people involved.

There may be circumstances that do not fit this definition. In these cases or any others, colleges can seek advice or clarification from the Council's chief auditor.

## **Guidance Notes and Self-assessment**

69 The guidance notes contain elements of good practice identified by the Council's audit service during its work with colleges to date. They are intended to assist colleges in complying with the mandatory requirements, and to enable them to review and enhance their own system of internal control.

70 The guidance notes contain three checklists which governors and college management may wish to use in reviewing audit arrangements at their college. The checklists reflect both those parts of the code and the guidance notes which the Council considers to be essential to successful audit arrangements at colleges, and those the Council views as good practice. A checklist for the self-assessment of internal audit arrangements at colleges is at appendix 8 to supplement B, that for external audit arrangements is at appendix 2 to supplement C and that for the college audit committee is at appendix 4 to supplement A.

71 Many colleges will already have taken steps to review their arrangements for internal and external audit, when they retender the service. The checklists are intended to assist colleges in further reviews of their audit arrangements.

72 Circular 97/22 *Joint Working: Audit and Inspection* informed colleges of the new arrangements for closer working between the Council's audit service and the inspectorate from September 1997. It also provided guidance to colleges undertaking self-assessment, additional to that provided in Circular 97/12. The checklists published here do not form part of the inspection framework, although colleges preparing for inspection may wish to take account of these checklists when carrying out self-assessment.



## **Annexes**





# Mandatory Audit Requirements

1 The following requirements within this code are mandatory for:

- governing bodies of colleges receiving funds from the Council under their financial memorandum with the Council
- the internal audit service and external auditors of colleges, which are obliged to comply with the requirements, by the governing bodies of the colleges.

## Responsibility for Internal Control

2 The governing body of each college must ensure that there is a sound system of internal control within the college (code, paragraph 28).

3 The college's governing body must ensure that its responsibilities for proper financial management, for the effectiveness of the whole system of internal control and management systems for the economy, efficiency and effectiveness of the college's activities have been properly discharged (code, paragraph 31).

4 Funds are paid by the Council pursuant to section 5 of the Act to meet expenditure eligible for funding under that section, and must be used in accordance with the purposes for which they are granted (code, paragraph 25).

## College Audit Committee

5 The governing body of each college must establish an audit committee. The audit committee must adopt an advisory role and examine the college's systems of internal control through the work of the college's internal audit service and the external auditor (code, paragraph 31).

6 The audit committee must be properly constituted by the governing body and given sufficient authority in its relationships with the governing body, governors and management. The audit committee of each college must have the right of access to obtain all the information it considers necessary from members of the college's staff and governors, and to consult with the internal audit service and the external auditor directly (code, paragraph 32).

7 The governing body must set terms of reference for the audit committee. The governing body of each college must not add to these terms of reference responsibilities that require the audit committee to adopt an executive role, or its members to offer professional advice to the governing body, outside their role as governors (code, paragraph 34).

8 The audit committee must consist of at least three members, with at least one having relevant skills and experience. Members of the audit committee must not have executive authority in the college, or be members of the finance committee or equivalent (code, paragraph 35).

9 The governing body must determine the membership of the audit committee and the terms on which they are to hold and vacate office (code, paragraph 36).

## Appointment of Internal Audit Service and External Auditor

10 On joining the further education sector, or when mergers occur, colleges must have in place an internal audit service and external auditor with effect from the first day of operation of their financial memorandum with the Council. If the provider is changed, the contract with the incoming provider must start on the day after expiry of the contract with the outgoing provider to ensure continuity of provision (code, paragraph 54).

11 Colleges must hold a competition for both quality and price at least every five years, or when the internal audit service provider or external auditor undergoes a significant change which affects the provision of the service. A new competition must also be held where the college undergoes a merger (code, paragraph 55).

12 The college must consult the Council's audit service on its shortlist of providers tendering for either, or both, the internal audit service and external audit. The college must send copies of the audit proposals to the Council, to assist in the consultation process (code, paragraph 56).

13 Colleges must not appoint an external auditor whose letter of engagement includes any limitation of liability in respect of external audit 'certification' work. Auditors may negotiate a limit on liability for work other than external audit certification work. The governing body must specifically consider and approve any request for a liability restriction.

*The requirements relating to the limitation of liability of auditors are not yet finalised* (code, paragraphs 58 and 59).

14 The college must inform the Council's chief auditor, without delay, of the removal or resignation of the internal audit service or the external auditor and the circumstances surrounding this (code, paragraph 62).

15 Where the internal audit service or the external auditor cease to hold office for any reason, they must provide the governing body with either a statement of any circumstances connected with the removal or resignation which they consider should be brought to the governing body's attention or a statement that there are no such circumstances (code, paragraph 62).

### **Independence of Audit**

16 Each governing body must, in accordance with the financial memorandum with the Council, appoint an internal audit service in accordance with guidance from the Council. It must be distinct from the external auditor and from college management even if provided in-house, and without any executive, management or operational responsibilities outside internal audit (code, paragraph 37).

17 The head of internal audit must have direct access to the principal and to the governing body, normally through the chairman of the audit committee (code, paragraph 46).

18 Each college must grant both the head of internal audit and the external auditor the right of access to the chairman of the audit committee and also the right to ask the chairman to convene a meeting, if necessary with, or without, other participants as appropriate (code, paragraph 61).

19 The internal audit service must have unrestricted access to all documents, records, assets, personnel and premises of the college, its companies and to relevant documents of outward collaborators, and be authorised to obtain such information and explanations as considered necessary by the college internal audit service (code, paragraph 47).

20 The operation and conduct of the college internal audit service must comply with the standards of internal audit which have been promulgated by HM Treasury standards and included in GIAM (code, paragraph 40).

21 If the college internal audit service or external auditor are called upon to carry out specific investigations and additional work, whether audit or otherwise, the governors and the auditors must ensure that such reviews do not compromise their objectivity, independence or achievement of the audit plans when forming their audit opinions (code, paragraph 63).

22 The work of the college internal audit service must include the whole system of internal control of the college including all its operations, resources, personnel, services and responsibilities for other bodies. It must cover all activities associated with the college, including activities delivered by college companies or joint ventures or through collaborative provision, and be extended to those that are not funded by the Council (code, paragraph 41).

23 The college must receive from its internal audit service timely strategic and annual plans formulated according to the service's own priorities. These plans must be approved by the governing body on the recommendation of the audit committee at the start of the year to which they relate, and in any event, before the commencement of work (code, paragraph 42).

24 Each college must devote sufficient resources to internal audit, having regard to the advice given by the head of internal audit. Where existing resources are inadequate to meet the need identified, the internal audit service must draw this fact to the attention of college management and the governing body through the audit committee. Where agreement cannot be reached on the level of internal audit resources, the college must report this to the Council's chief auditor (code, paragraph 43).

### **Audit Reporting**

25 The internal audit service must produce an annual report on the adequacy and effectiveness of operation of the whole system of internal control of the college. *The level of assurance required of internal auditors is still unresolved* (code, paragraph 44).

26 Each college's internal audit annual report must be received and be available to the governing body before the responsibility statement, contained within the college's annual financial statements, is signed (code, paragraph 45).

27 The external auditor must be concerned with the requirements of the Council to report on:

- the regularity of transactions, that is, that any terms and conditions attached to the funds provided to colleges have been complied with (code, paragraph 49)
- the accuracy of certain statistical returns (code, paragraph 49).

### **Due Professional Care**

28 Auditors must exercise both due care and professional care in their work (code, paragraph 60).

### **The Council's Audit Service**

29 Colleges must, through their contract with the internal audit provider, allow the Council unrestricted access to all records, information and assets which the Council considers necessary to fulfil its responsibilities, including internal audit working papers which should be the property of the college, and key internal audit service personnel. *The arrangements relating to access to working papers have not yet been finalised* (code, paragraph 48).

30 The Council's audit service and the NAO must have unrestricted access to all records, information and assets and be able to require any staff or governor to give any explanation which it considers necessary to fulfil its responsibilities, including internal and external auditors' working papers and personnel (code, paragraph 53).

31 The college external auditor must comply with any requests from the Council's audit service and the NAO for access to any information, which it considers necessary to fulfil its responsibilities, obtained or prepared during the course of its audit (code, paragraph 53).

32 The Council's audit service assesses the adequacy and effectiveness of the system of internal control at colleges by performing reviews of colleges' governance and management arrangements. It aims to minimise duplication of audit effort by seeking to rely upon the work of colleges' internal audit services. It also evaluates the effectiveness of the operation of college audit committees. Such assessments will have regard to this code and any other guidance issued by the Council (code, paragraph 27).

### **Fraud and Irregularity**

33 The financial memorandum between the college and the Council states that the governing body is responsible for ensuring (that is, must) that the financial, planning and other management controls, including controls against fraud and theft, applied by the college are appropriate and sufficient to safeguard public funds (code, paragraph 64).

34 Where the external auditor identifies a serious weakness or an accounting or other control breakdown it must be reported to the principal, the chairman of the governing body and the chairman of the audit committee without delay (code, paragraph 64).

35 Where the audit committee feels there is evidence of irregularity, fraud, corruption, or any impropriety, the chairman of the committee must notify the principal and the chairman of the governing body (code, paragraph 67).

36 Colleges must have a written policy on the process to be followed when evidence of potential irregularity, including fraud, corruption, or any impropriety, is discovered (code, paragraph 65).

37 The head of internal audit must issue written procedures to auditors on the action to be taken if they discover fraud or irregularity (code, paragraph 66).

38 The college, its internal audit service and, where appropriate, its external auditor must report to the Council's chief executive, copied to the chief auditor, without delay, serious weaknesses, significant frauds or major accounting and other control breakdowns (code, paragraph 68).



---

# HM Treasury Internal Audit Standards

The operation and conduct of internal audit must comply with the mandatory standards set out in HM Treasury's *Government Internal Audit Manual 1996* (GIAM).

Modifications used to tailor their applicability to colleges are shown in square brackets [thus].

## 1 Scope

Internal audit embraces the whole internal control system of the [college] including all its operations, resources, services and responsibilities for other bodies.

## 2 Independence

Internal audit must be sufficiently independent to enable auditors to perform their duties in a manner which will allow professional judgements and recommendations to be effective and impartial. Internal auditors should be independent of the activities they audit.

## 3 Planning

Internal audit work should be planned at all levels of operation in order to establish priorities, achieve objectives and ensure the efficient and effective use of audit resources.

## 4 Audit Approach

The [internal audit service] should ensure that audit objectives and methods enable them to discharge their responsibility to evaluate the internal control system. Internal auditors should obtain and record relevant, reliable and sufficient audit evidence to support audit findings and recommendations.

## 5 Controlling

Internal audit work must be controlled at all levels of operation to achieve objectives and ensure the economic and efficient use of resources.

## 6 Reporting

The findings and recommendations arising from each audit must be promptly reported to management and followed up to ascertain action arising therefrom. A summary of audit activities must be submitted to the [governing body].

## 7 Due Professional Care

In carrying out their duties internal auditors must exercise due professional care.

## 8 Relationships

Relationships with management, staff, external auditors and other review agencies must be centred on the need for mutual confidence, understanding of role and co-operation.

## 9 Staffing and Training

Internal audit should be appropriately staffed in terms of numbers, grades and experience, having regard to its objectives and standards. Internal auditors must be properly trained to fulfil their responsibilities.

# Index

---

# Index

This index covers material in the following FEFC publications:

*Audit Code of Practice* (the code)

*Annex A to Audit Code of Practice: Mandatory Audit Requirements*

*Annex B to Audit Code of Practice: HM Treasury Internal Audit Standards*

*Supplement A to Audit Code of Practice: Guidance Note on the College Audit Committee*

*Supplement B to Audit Code of Practice: Guidance Note on the College Internal Audit Service*

*Supplement C to Audit Code of Practice: Guidance Note on the College External Auditor*

*Supplement D to Audit Code of Practice: Guidance Note on Areas Common to the College Internal Audit Service and External Auditor*

All the number references in this index refer to paragraph numbers. Suffixes are used to denote different volumes. The suffixes used are shown below.

## Suffixes

aa Annex A to the code

bb Annex B to the code

supp(a) supplement A to the code

supp(a1) appendix 1 to supplement A

supp(a2) appendix 2 to supplement A

supp(a3) appendix 3 to supplement A

supp(a4) appendix 4 to supplement A

supp(b) supplement B to the code

supp(b1) appendix 1 to supplement B

supp(b2) appendix 2 to supplement B

supp(b3) appendix 3 to supplement B

supp(b4) appendix 4 to supplement B

supp(b5) appendix 5 to supplement B

supp(b6) appendix 6 to supplement B

supp(b7) appendix 7 to supplement B

supp(b8) appendix 8 to supplement B

supp(c) supplement C to the code

supp(c1) appendix 1 to supplement C

supp(c2) appendix 2 to supplement C

supp(d) supplement D to the code

supp(da) appendix to supplement D

This index contains all bibliographic references found in all the above publications. It also provides a gloss for any abbreviations used in those publications. For example, to find out what the abbreviation 'ANA' stands for, look under 'ANA', where the full wording is set out.

---

accountability, 18–30

of Council, 25–27, 5 supp(d)

of governing bodies, 28–29

additional services, 63, 21aa, 23–24 supp(b), 9–10 supp(d)

assurance, 5, 38, 44, 60, 3 supp(b1), 2–3 supp(b1), 2–6 supp(b6)

ANA *see* audit needs assessment

annual report, 44–45, 25–26aa, 2 supp(a), 25–26 supp(a), 1 supp(a3), 20–21 supp(b), 42–43 supp(b), 12 supp(b2), 19–20 supp(b2), 1–9 supp(b6)

assignment reports, 2, 12 supp(a), 41–43 supp(b), 1–4 supp(b5)  
timing of, 29 supp(b),

Association of Authorised Public Accountants, 52

Audit Commission for Local Authorities, 52

audit committee (college), 31–36, 5–9aa  
annual report of, 25 supp(a), 1 supp(a3), 42–43 supp(b)  
appointment of, 27  
access rights, 32, 46–47  
authority of, 6, 31, 3 supp(a)  
chairman of, 46  
and governing body, 31–32, 34, 36, 42–43, 64–67, 5–9aa, 17aa, 35–35aa, 2–7 supp(a), 14–16 supp(a), 18–23 supp(a), 25–26 supp(a)  
meetings of, 18–21 supp(a), 23 supp(a)  
membership of, 35–36, 8–9aa, 13–17 supp(a), 1 supp(a4)  
and planning, 42  
role of, 31, 34, 2 supp(a), 8–12 supp(a), 4 supp(b7)  
terms of reference of, 34, 7aa, 2 supp(a), 4 supp(a), 2 supp(a4)

audit committee (Council), 27



---

audit needs assessment, 27–31 supp(b), 6–15  
supp(b3)

audit service  
    additional services by, 63, 24 supp(b),  
    7 supp(b2), 2–18 supp(d)  
    academic, 14 supp(b)  
    access rights of, 46–47, 61  
    appointment of, 6, 37, 54–59, 10–15aa  
    change of, 54–56, 47 supp(b), 23 supp(b2),  
    25 supp(b2)  
    Council's, 14, 23, 53, 30–33aa  
    and inspection, 71  
    internal, 27, 37–48, 54–63, 27, 1–4 supp(b1),  
    2–4 supp(b), 1 supp(b1), 5 supp(b7)  
    engagement, terms of, 58–59  
    external, 49–53, 54–63, 1–14 supp(c)  
    resignation of, 62  
    responsibilities of, 8–9 supp(b2)  
    selection of, 54–57, 2–6 supp(d)  
    standards, 40, 41–47, 1–9ab, 3 supp(b),  
    12–21 supp(b), 10–12 supp(b2)  
    terms of reference of, 18 supp(b)

audit, systems, *see* systems audit

Auditing Practices Board, 13, 15 supp(c1)  
    guidance from, 13  
    standards of, 13

authority  
    of audit committee, 35

benchmarks, *see* performance indicators

C&AG *see* comptroller and auditor general

Cadbury committee, 5 supp(a)

cashflow forecast, 51

Chartered Association of Certified Accountants, 52

Chartered Institute of Public Finance and  
    Accountancy, 52

checklists, use of, 69–71

chief auditor, 43, 55, 62

chief executive, 22–23  
    as accounting officer, 22–23, 25  
    of college, *see* principal, college

Circular 92/07, 5, 10 supp(c)

Circular 92/12, 5

Circular 92/22, 72

Circular 94/26, 4 supp(c)

Circular 97/12, 72

Circular 97/28, 4 supp(c)

code of practice, 1–17  
    mandatory requirements in, 11–12  
    need for, 6  
    readership, 1–5  
    review of, 17  
    scope of, 7–10  
    updates, 16–17

collaborative provision, 41, 5 supp(b2)

*College Governance: A Guide for Clerks*, 15 supp(a),  
    23 supp(a)

Committee of Public Accounts, 30, 16 supp(a),  
    2 supp(b), 3 supp(b7)

companies, limited 49

*Companies Act 1985*, 49, 4 supp(c), 10 supp(c1)  
    16 supp(d)

*Companies Act 1989*, 52

competition, 55, 11–12aa, 2–6 supp(d)

comptroller and auditor general, 10, 20–21

consortia, 10

Council, 6, 25–27  
    access rights of, 48, 53, 30–31aa, 12–13 supp(c)  
    audit service of, 14, 23, 29–33aa  
    chief auditor of, 55, 62, 42 supp(b)  
    chief executive of, 22–23, 25  
    and external auditor, 53

CPA, *see* *Committee of Public Accounts*

Customs and Excise, 8

cycle, audit, 17

Department for Education and Employment, 6, 19,  
    22–24

DfEE *see* Department for Education and  
    Employment

due care, 60

due professional care, 60, 28aa, 7bb

engagement, terms of, 58–59

ESF *see* European social fund

European social fund, 24

European Court of Auditors, 8

evidence, 8–9 supp(b4)

external audit, 49–53, 54–63

---

---

external auditor 49–53  
 access rights of, 61  
 appointment of, 10–15aa  
 and Council, 53  
 eligibility of, 52  
 letter of engagement of, 13aa  
 responsibilities of, 64  
 resignation of, 62, 14–15aa  
 role of, 49  
 selection of, 54–59

final funding unit claim, 50, 58

finance committee, 35, 5–7 supp(a)

financial memorandum, 6  
 and financial controls, 64  
 between DfEE and Council, 6, 22, 25, 27  
 between Council and colleges, 6, 26–28, 31, 54, 64

financial regulations, 65, 19 supp(b)

financial statements, 45, 49, 26aa

*Financial Services Act 1986*, 26 supp(c1)

franchising *see* collaborative provision

fraud, 64–68, 33–38aa, 26–28 supp(a), 24 supp(b), 44–46 supp(b), 21 supp(b2), 20 supp(c1)  
 policy statement on, 65, 26 supp(a)

funds, 25–27

Further Education Funding Council *see* Council

further education sector, 55, 10aa

*Further and Higher Education Act 1992*, 19, 26  
 schedule 8 to, 52  
 section 5 to, 25, 4aa  
 section 53 to, 21

GIAM *see* *Government Internal Audit Manual*

good practice, 2, 12, 33, 69–70

governance, 15 supp(a)

governance and management, 27

governing body, 1, 28–29, 31–32, 2–3aa, 5–9aa  
 responsibilities of, 28–30, 64  
 and selection of audit service, 59

*Government Internal Audit Manual*, 13, 38, 40, 20aa, 1–7ab, 3 supp(b), 7 supp(b), 18 supp(b), 1–4 supp(b1), 2 supp(d)

*Guidance for Internal Auditors*, 3 supp(b)

HEFCE *see* Higher Education Funding Council for England

Higher Education Funding Council for England, 8, 18

HM treasury internal audit standards, 40, 41–45, 20aa, 1–9ab, 3 supp(b), 1–4 supp(b1) 12–21 supp(b)

Home Office, 8

hold harmless letters, 48 supp(b), 14 supp(c)

ICAEW *see* Institute of Chartered Accountants in England and Wales

indemnity, 59

independence, 31, 35, 63, 16–24aa, 2ab, 22–24 supp(b), 39 supp(b), 13–14 supp(b2), 8 supp(d)

Inland Revenue, 8

inspection, 7, 72

Institute of Chartered Accountants in England and Wales, 52, 48 supp(b), 13 supp(c)

Institute of Chartered Accountants in Ireland, 52

Institute of Chartered Accountants of Scotland, 52

internal audit, 27, 37–48, 54–63, 1–4 supp(b1), 2–4 supp(b)  
 access rights of, 46–47, 61, 19aa  
 Council access to, 48  
 definition of, 38, 1 supp(b1)  
 resignation of, 62  
 resources for, 43, 30–31 supp(b), 13–15 supp(b3)  
 responsibilities of, 38, 25–26aa  
 selection of, 54–59, 5–11 supp(b)  
 standards of, 40, 41–47, 1–9bb

internal control, 19, 27–29, 37–38, 2–4aa, 1–4bb, 25 supp(a), 2 supp(b1), 15–16

instruments of government, 27

letter of engagement, 58–59, 18 supp(b), 1–26 supp(c1)  
 breach of, 28 supp(b)

liability, 5, 58–59, 22–25 supp(d)  
 limitation of, 58–59, 13aa, 26–28 supp(d)

limited companies, 49

local authority, 18

management, college, 38

mandatory requirements, 11–12, 1–38 supp(a)

materiality, 5 supp(b6)

merger, 54–55

---

---

*must*  
    meaning of, 11

NAO *see* National Audit Office

National Audit Office, 9–10, 3 supp(b7)  
    authority of, 21, 11 supp(c)  
    its observation of Council’s work, 23  
    its visits to colleges, 21

*National Audit Act 1983*, 21, 3 supp(b7)

National Health Service, 52

non-Council-funded provision, 41

OCP *see* collaborative provision

PAC *see* Committee of Public Accounts

parliament, 19, 20–21, 25

performance indicators, 51, 1–4 supp(a1), 1–2  
    supp(a2), 31 supp(b), 10–11 supp(c)

performance review, 10 supp(a)

principal, college  
    responsibilities of, 30

private sector, 18, 4 supp(b)

*Proper Conduct of Public Business, The*, 16 supp(a)

public accounts committee, *see* Committee of Public  
    Accounts

public funds, 18–19, 20, 25–26

public sector, 4 supp(b)

recovery plans, 51

reorganisation, 55

*Report of the Committee on the Financial Aspects of  
    Corporate Governance*, 5 supp(a)

reporting, 44–45, 25–27aa, 39–43 supp(b),  
    16–20 supp(b2)

risk assessment, 26 supp(b)

secretary of state for education and employment, 25

selection, of audit service, 54–57, 2–6 supp(d)

self-assessment, 72, 29 supp(a), 1–3 supp(a4),  
    53 supp(b), supp(b8), 14 supp(c), supp(c2)

*should*  
    meaning of, 1 supp(a)

standards of audit, 13

statistical returns, 49, 27aa, 10–11 supp(c)

strategic plans, 42–43, 23aa, 26 supp(b),  
    2–5 supp(b3)

substantive testing, 36 supp(b)

systems audit, 33–38 supp(b), 4 supp(b1),  
    1–4 supp(b4), 6–7 supp(b7)

TEC *see* training and enterprise council

tendering, 55–56 supp(d)

terms of engagement, 58–59, 7 supp(d)

terms of reference, 18 supp(b), 1–24 supp(b2)

training and enterprise council, 8, 18, 24

*Trustees Investment Act 1961*, 7 supp(c1)

value for money, 59, 49–52 supp(b), 1–8 supp(b7),  
    supp(d)

VFM *see* value for money

working papers  
    access to, 5, 48, 53  
    as property, 48

---