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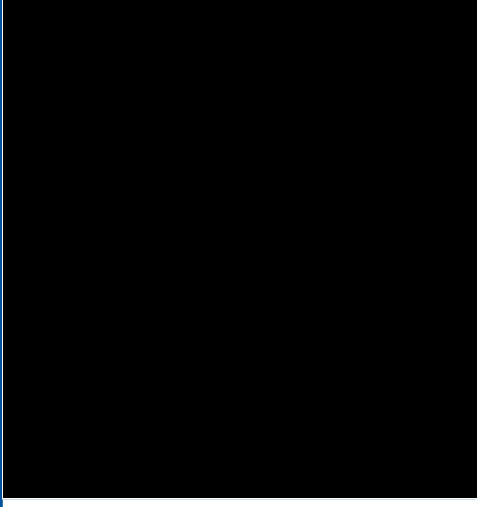


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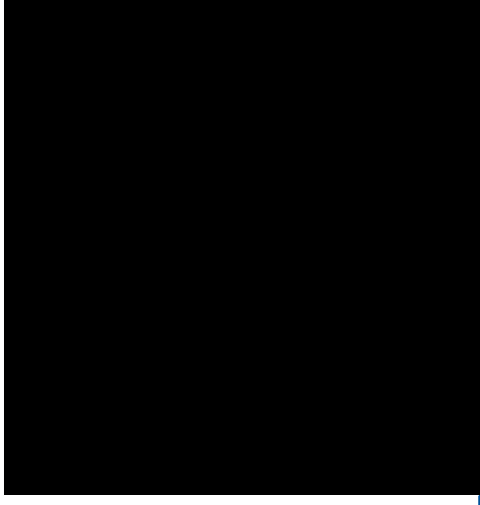
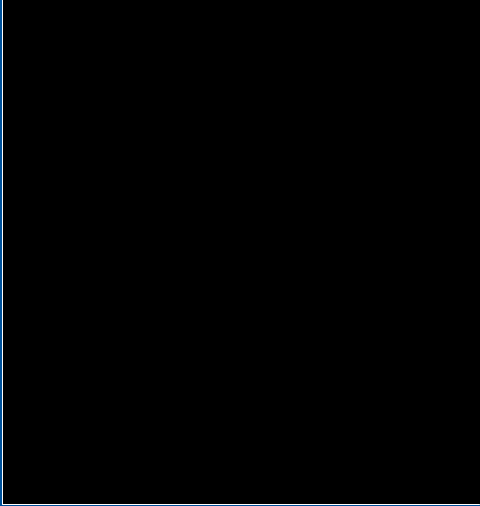


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Guidance on the Interim Audit Code of Practice

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Questions and Further Advice

In response to questions regarding this guidance or any other aspect of the Interim Code, the AoC offers confidential advice and support on governance issues which is available to all further education and sixth-form colleges.

Telephone helplines are open Monday to Friday, 08.30 to 17.15, freephone 0800 652 0535 or e-mail: fegovernorsupport@aoc.co.uk

Advice can also be obtained from the LSC, and for further information please contact:

National Provider Financial Assurance Division
Learning and Skills Council
Cheylesmore House
Quinton Road
Coventry
CV1 2WT

Tel: 024 7649 3975

Website: www.lsc.gov.uk

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29–31 Broad Street
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Tel: 0117 372 6517

e-mail: phil.eames@lsc.gov.uk

Reference Sources

LSC Circular 03/04 (March 2003), together with its Supplements A and B.

LSC publication *A Guide to Risk Management in Further Education*, published May 2002.

Instrument and Articles of Government, as amended by the Department for Education and Skills (DfES) and effective from 1 April 2001.

Government Internal Audit Standards, HM Treasury audit policy and advice, October 2001.

Internal Control: Guidance on the Combined Code, Institute of Chartered Accountants in England and Wales (ICAEW), September 1999 ('The Turnbull Report').

The updated Governor Training Materials produced in 2002 and the Clerks' Training Materials produced in 2001 also provide useful background to the work and responsibilities of audit committees.

Guidance on the Interim Audit Code of Practice

Introduction

The Learning and Skills Council (LSC) issued an Interim Audit Code of Practice (the Interim Code) as Circular 03/04 in March 2003. The Interim Code superseded *Further Education Funding Council (FEFC) Circular 98/15*, published in May 1998.

For colleges, the LSC inherited the responsibilities and processes of the FEFC. This included the FEFC *Audit Code of Practice for FE Colleges*, which defined the FEFC's mandatory requirements for audit and provided guidance. The LSC has now taken on new responsibilities for colleges under the *Learning and Skills Act 2000*, and has developed its own processes and procedures to meet these.

The LSC funds a greater range of post-16 learning providers than the FEFC did, and therefore the 1998 Code was not sufficiently wide-ranging for the scope of the LSC's work. In addition, the LSC needed to reflect developments in colleges' accountability since 1998. The LSC has therefore produced an Interim Code, which includes a summary of the LSC's audit requirements for all providers.

Audit arrangements are a direct product of the LSC's terms and conditions of funding, and the LSC is committed to harmonising and simplifying these arrangements across providers as far as possible. The LSC intends to integrate its harmonised audit arrangements into later versions of the Audit Code of Practice, so that the Code will eventually be a condition of funding for all providers. Later versions of the Code will continue to focus on minimum audit requirements, with further supplementary guidance being produced jointly with representative bodies of providers.

The LSC, working together with the Association of Colleges (AoC), the Association of College Registrars and Administrators (ACRA) and internal audit providers, ran a series of workshops across the regions during the spring of 2003, introducing the Interim Code together with the main changes from the 1998 publication. Delegates at these workshops were consulted on aspects of the Interim Code where guidance would be helpful.

The AoC has been a strong supporter of 'bureaucracy busting' and an advocate of greater clarification in the many documents that act as guides to all college activities, including the Interim Code. The LSC asked colleges whether they wished the LSC to issue guidance to support the Interim Code, or whether colleges wanted to develop their own guidance with LSC input. The answer unequivocally was that guidance would be useful, and that colleges should develop it themselves. The AoC has supported publication of this guidance because it is a timely reminder of the sector's responsibilities for good 'corporate governance'. This guidance document will help governors and others to understand the difference between 'corporate governance' on the one hand and 'governance processes' on the other.

In addition to widening the remit of the audit committee, the Interim Code underlines the value of the audit committee, both to colleges and to those to whom colleges are accountable. Hopefully, this will encourage more governors to volunteer their services for the audit committee, and especially so where individuals have relevant experience in other fields that can be translated easily into the audit role in further education (FE).

Much of what is issued by the LSC as guidance is misunderstood to be further requirements. That is not what this publication is for, and the LSC will not use it as a basis for judging colleges.

The aim of this joint publication between AoC/ACRA and the LSC is to provide guidance on some of the practical aspects of the Interim Code in relation to FE college audit committees as requested at the regional workshops. As guidance, it contains no additional requirements on colleges. This guidance is not, therefore, intended to be a definitive or authoritative statement of the Interim Code, but should be read alongside the Interim Code for a full understanding of all the audit requirements.

The practical aspects of this guidance have the broad aim of promoting diversity of approach, setting out suggested ways of implementing the Interim Code.

The Interim Code fully embraces the concept of risk management as an embedded management function within colleges. This has implications for audit committees and the scope of the work undertaken by audit providers. This guidance should also be of assistance to managers and governors in performing this very important role.

The guidance which follows is in four sections:

- 1 key summary points drawn from the Interim Code;
- 2 the role of FE College audit committees;
- 3 questions to consider in the assessment of the performance of auditors; and
- 4 suggestions for the format and layout of the annual report of the audit committee.

In covering the above, this document expands on the Interim Code to offer guidance on corporate governance issues and the role of internal auditors.

This guidance is intended to be of interest to managers, governors, clerks and auditors of FE

colleges funded by the LSC, and to executive directors, finance directors and heads of provider financial assurance (PFA) at local LSCs.

The publication was written by David Coates, Member of the AoC/ACRA Steering Committee. David is also clerk to the corporation at The People's College Nottingham, West Nottinghamshire College and Brooksby Melton College.

Section 1: Key Summary Points

- 1 The Interim Audit Code of Practice ('the Interim Code') supersedes FEFC Circular 98/15, published in May 1998.
- 2 Release of the Interim Code followed consultation with colleges, providers, auditors and local LSCs during summer and autumn 2002.
- 3 The Interim Code has been released by the LSC pending the final version, which will encompass all providers funded by the LSC. It is likely to be in force for the financial years 2002-03, 2003-04 and 2004-05. The LSC will provide further updated advice on this by letter.
- 4 The Interim Code came into immediate effect on its release in January 2003 and colleges are expected to have commenced work during 2002-03 to implement its requirements. Full compliance is expected for the 2003-04 year.

Features of the Interim Code

- 5 The Interim Code is in three parts: a covering circular and two Supplements (A and B).
- 6 The Interim Code focuses on the mandatory audit requirements and does not include any supplementary guidance notes.
- 7 Generally, the words 'must' and 'will' are used to describe aspects of the Interim Code that are mandatory, and the words 'should' or 'may' are used to describe an aspect upon which there is a degree of discretion or room for interpretation. The word 'should' is used infrequently.
- 8 References in the Interim Code to the Financial Memorandum (under FEFC Circular 99/48) remain in force for the time being, although this is also being updated by the LSC.

Terminology and definitions

- 9 The Interim Code introduces new terminology and some changes in terminology, including:
 - 'Financial Statements Auditor' replaces the previous term 'External Auditor';
 - 'Funding Auditor' replaces the previous term 'ISR¹(or ILR²) Auditor'; and
 - the abbreviation 'IAS' is used to describe the 'Internal Audit Service'.
- 10 The Interim Code also uses the expression 'governing body' to refer to the corporation as defined in the Instrument and Articles of Government. For consistency with the Interim Code, the term 'governing body' has also been used in this guidance, and has the same meaning as that used in the Interim Code and the Instrument and Articles of Government.

Interim Audit Code Reference

paragraph 5,
Supplement A

¹Individualised Student Record

²Individualised Learner Record

Section 2: Further Education College Audit Committees

The Role of Audit Committees

paragraph 33,
Supplement A

- 1 The Interim Code introduces a new role for the Audit Committee to advise the governing body on the adequacy and effectiveness of the college's systems of internal control *and its arrangements for risk management, control and (corporate) governance processes*, and securing economy, efficiency and effectiveness (value for money). This advice is primarily formed through a consideration of the work of the IAS, financial statements auditors and funding auditors. This role introduces a new focus and wider responsibility for audit committees in the effective management of risk and its wider remit incorporates a review of a college's corporate governance processes.
- 2 Corporate governance processes are not limited to those that surround the operation of the governing body, but are the wider processes that govern the relationship between the governing body, the senior management team, the college in general and the communities that colleges serve, acting in the public interest.
- 3 This wider role for the audit committee should not be seen as a definitive list of exclusive items. Each is interrelated and contributes to the effective corporate governance of the college. Corporate governance in an FE college context can be seen, therefore, as the processes of decision-making and accountability by colleges for the proper use of public funds. This is not dissimilar to the corporate governance responsibilities of a private sector company, except in an FE environment the 'shareholders' are the various stakeholders which have an interest in the college.
- 4 Governing bodies and college managers have primary responsibility for ensuring the adequacy and effectiveness of the college's corporate governance arrangements. All colleges are required to have an IAS, and it is this service which, if used properly, can provide the governing body, and the principal as the accounting officer, with an independent and objective appraisal of the college's risk management, control and corporate governance processes. The college's IAS should do this by measuring and evaluating the effectiveness of these processes in achieving the college's agreed strategic objectives contained in its strategic plan and development plan agreed with the LSC. The primary role of the IAS is to give an annual opinion on these processes and is therefore central to reviewing the effectiveness of the college's corporate governance arrangements.
- 5 The Government Internal Audit Standards³(GIAS) sets out the broad standards which all IAS providers must follow, and defines the scope of their work as follows.

³Government Internal Audit Standards, HM Treasury audit policy and advice, October 2001.

Risk management, control and (corporate) governance comprises the policies, procedures and operations established to:

- a establish and monitor the achievement of the college's objectives;
 - b identify, assess and manage the risks to achieving the college's objectives;
 - c advise on, formulate and evaluate policy;
 - d ensure the economical, effective and efficient use of resources;
 - e ensure compliance with established policies (including behavioural and ethical expectations), procedures, laws and regulations;
 - f safeguard the college's assets and interests from losses of all kinds, including those arising from fraud, irregularity or corruption; and
 - g ensure the integrity and reliability of information, accounts and data, including internal and external reporting and accountability processes.
- 6 In practical terms the above means that the college's strategic plan, development plan and the risk management assessments are the starting points for determining the content of the internal audit annual plan. Taking these as starting points, colleges should expect the following to be included as a minimum within their internal audit plans.

To be included in annual plans:

- a the operation of (corporate) governance processes; and
- b the operation of risk management processes.

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

- a long-term planning, including formulating bids for allocations from the LSC and non-LSC funding;
- b learner numbers systems and funding claims, where the IAS and the audit committee decide not to accept the LSC statement or the LSC statement is not available;
- c other control aspects of learner numbers systems and income streams not covered by the Funding Auditor;
- d financial planning, budget setting, monitoring and forecasting;
- e fundamental financial accounting and asset controls;
- f significant partnerships including college subsidiary or associated companies, franchising, joint ventures, subcontracted direct learning provision and learndirect hubs where the college is the recipient college;
- g procurement and payments;

Annex C,
Supplement B

- h capital project planning, management and evaluation;
- i security of the IT infrastructure and disaster recovery;
- j contractors of the college who provide any service that handles or processes college finances or management information in any form; and;
- k personnel, the appointment and departure of staff and senior postholders both full-time and part-time, the payment of salaries, wages and other staff payments.

Terms of reference

Annex B,
Supplement B

7 Supplement B of the Interim Code contains minimum terms of reference for college audit committees. Additional terms may be added to the committee's remit, but with the following limitations, in that terms may not be added which:

paragraph 34,
Supplement A

- a require the audit committee to adopt an executive role;
- b require members of the audit committee to offer professional advice to the governing body outside their role as governors; or
- c cause the committee to lose its primary focus on the adequacy and effectiveness of the college's audit arrangements and risk management, control and governance processes.

Operation of the audit committee

Annual cycle of business

paragraph 43 and
table on page 11 of
Supplement A

- 8 During a college year, an audit committee can be dealing with issues from three separate years: the current year; the previous year; and the forthcoming year. The Interim Code includes a minimum schedule of business to be followed by an audit committee designed to assist governors and staff in understanding the annual cycle. It states the expected timing for committees to be dealing with mandatory responsibilities and also indicates those items which should be referred to the governing body for approval.
- 9 A further copy of the cycle is at page 12 of this guidance, which has been adapted to include the annual report on risk management referred to in the LSC Assistant Director of Finance's letter to principals dated 28 August 2003. It is suggested that colleges review their own arrangements against the annual cycle. Section 4 of this guidance also includes the annual report on risk management as a suggested part of the audit committee's annual report to the governing body.
- 10 Further detail on approaches to risk management can be found in the LSC's *Guide to Risk Management*⁴, published in May 2002. The Guide includes the annual risk management report to the audit committee, to be prepared by the principal (or a nominated member of the senior management team), for consideration by the audit committee in either the summer or autumn terms (although the LSC letter of 28 August

⁴Guide to Risk Management, LSC May 2002.

2003 assumes November). The Guide also explains how the annual report is key to the college's compliance with the 'Turnbull Report'⁵ recommendations. The 28 August letter also includes an extract of the Guide in relation to the annual report and suggests that it should include the following:

- a the risk management approach adopted during the year; and
- b a summary of performance against the college's risk management plan, identifying:
 - i any issues arising in each of the significant risk areas and how these issues were addressed;
 - ii details of key performance indicators with comparators where possible;
 - iii details of any actions or deadlines which were not achieved and how these are being resolved;
 - iv details of any changes made to the scope of the risk management plan during the year as a result of new initiatives or developments; and
 - v an overall summary and conclusion on the adequacy of the process in discharging the corporation's duties.

Clerk, membership and chair of the audit committee

- 11 There has been debate in the past on the interpretation of questions of whether:
- a a person who is a senior manager at the college can also be clerk to the audit committee;
 - b staff and student governors can be members of the audit committee;
 - c a person who is not a governor can chair the audit committee; and
 - d the quorum for meetings.

The above questions are addressed in the following paragraphs.

Clerk to the audit committee

- 12 The Interim Code states that the clerk to the audit committee should normally be the clerk to the governing body. Furthermore, it goes on to state that where the clerk is also a senior manager or has significant financial responsibility, another individual should act as clerk to the audit committee.
- 13 Audit committees are reliant on the independent advice they receive from their clerk to organise the business for meetings and progress actions with college managers. In cases where the clerk is also a senior manager, the governing body seeking to retain this arrangement for the audit committee should annually consider:

paragraph 39,
Supplement A

⁵Internal Control: Guidance on the Combined Code, ICAEW, September 1999 (the 'Turnbull Report').

- a whether there is an actual conflict of interest between the roles;
- b whether the clerk has the time available to provide the independent advice and to progress actions;
- c the frequency on which the conflict of interest (if any) occurs: for example, every meeting; periodic meetings; or just one part of an agenda; and
- d what additional arrangements (if any) need to be put in place both to avoid the clerk being placed in a conflict situation, and to preserve the independence and objectivity of the advice received – for example, separate job description and appraisal.

Membership

- 14 The Interim Code does not prevent a staff governor being a member of the audit committee. However, colleges seeking to include staff governors should ensure that the staff member:
 - a is not a senior post holder (Article 5(5) of the Instrument and Articles of Government refers); and
 - b is not likely to be involved on a day-to-day basis with any matters likely to be considered by the committee.
- 15 Whilst there is nothing to prevent a student governor from being a member of the audit committee, colleges seeking to have such members on the audit committee should ensure that the student:
 - a has sufficient expertise; and
 - b is over 18 years of age, as required by the Instrument and Articles of Government where expenditure and contracts are to be considered (Article 14(6) of the Instrument and Articles of Government refers).

Chair of the audit committee

- 16 The Financial Memorandum between the LSC and colleges requires audit committees to have amongst their membership a person with relevant financial or audit experience. This experience might be through a formal financial role, or (in general) someone who has experience of audit, and/or being audited, at a senior level in an organisation as complex as a college. In addition, this experience may come from a governor or from a person who has been co-opted onto the committee in the role of a co-opted external member. It is possible for the committee to include more than one co-opted external member.
- 17 The Interim Code states that a co-opted external member of the audit committee should not normally be appointed as its chair. This does not prevent a co-opted external member being the chair of the audit committee, although it states a preference that this should not normally be the case. This is because the chair of the audit committee needs to be able to address meetings of the governing body and attend all meetings as of right. In cases where the chair of the audit

paragraph 38,
Supplement A

committee is a co-opted external member, then the governing body should ensure:

- a that the chair of the audit committee has an automatic right to attend and address all meetings of the governing body and receives all papers for consideration;
- b that a vice-chair who is a governor (or another nominated governor) is appointed to feed back issues from the committee in the absence of the committee chair; and
- c that there is a balance of expertise and complementary skills amongst the membership of the committee.

Quorum for meetings

- 18 Having discussed the above issues concerning staff, student and co-opted external members, it should be noted that all members of the audit committee count towards the quorum, unless the governing body makes specific rules to the contrary in the terms of reference for the committee. If no specific rules are made, the following are possible (as extremes):
- a an audit committee with a membership of between three and five and a 40% quorum rule can hold a quorate meeting of two members; and
 - b if the two members are both co-opted external members (and no specific rule has been made preventing them being counted towards the quorum), the meeting will still be quorate.

Operation

- | | |
|---|-----------------------------------|
| <p>19 The audit committee must receive a copy of the financial statements (year-end accounts) to inform its view on the financial statements management letter.</p> | <p>paragraph 35, Supplement A</p> |
| <p>20 The governing body must approve the financial statements on the recommendation of the audit committee or the finance committee or both committees. Comment should be made in the annual report where the audit committee is providing the advice on the financial statements (see Section 4).</p> | <p>paragraph 35, Supplement A</p> |
| <p>21 The committee's right to go into confidential session without management being present remains. The Interim Code contains a useful qualification of this point in that it should only go into confidential session when it is satisfied that it is appropriate to do so.</p> | <p>paragraph 40, Supplement A</p> |
| <p>22 The college's IAS are to be invited to all meetings of the audit committee, financial statements auditors and funding auditors are to be invited appropriate to the agenda.</p> | <p>paragraph 41, Supplement A</p> |
| <p>23 The audit committee must consider all significant findings or recommendations of auditors and progress actions with college management.</p> | <p>paragraph 42, Supplement A</p> |

paragraph 99,
Supplement A

Additional services

- 24 The audit committee is to be informed of all additional services being undertaken by the IAS, financial statements auditors or funding auditors. Where the cumulative value of this work by the IAS or financial statements auditors exceeds £20,000 in any 12-month period, the governing body must approve this in advance. These requirements are to ensure that the committee (and the governing body) is aware of other work being provided for the college and has an opportunity to consider whether there is any conflict of interest, and whether the audit service provider's objectivity, independence or ability to achieve audit plans have been (or are likely to be) compromised.

Monitoring performance

paragraph 44,
Supplement A

- 25 The requirement for audit committees to monitor the performance of the financial statements auditor and the IAS has been carried forward from the previous FEFC Code. The Interim Code suggests that audit committees might also wish to identify and approve annually appropriate performance indicators for the funding auditor. Colleges receive as a matter of routine a questionnaire from their funding auditor on the quality of the service the college has received. During the regional workshops it became apparent that audit committees were not generally being consulted for their views in completing these questionnaires.
- 26 The suggestion, therefore, that audit committees might wish to identify and approve annually appropriate performance indicators for the funding auditor, if taken up, will provide the committee (on behalf of the governing body) with an objective basis upon which to comment to the LSC on the performance of the funding auditor. If colleges wish to provide direct feedback to the LSC on the funding audit process or the performance of their funding auditors, they may contact the LSC ILR Contract Manager directly at the LSC national office.
- 27 Example performance indicator questions are included at Section 3 of this guidance.

Annual report of the audit committee

Annex B,
Supplement B

- 28 There is a new requirement in the Interim Code that the annual report of the audit committee is to be written for both the governing body *and the principal as the accounting officer for the college*. This follows practice in the higher education sector and also recognises the value that accounting officers will place on the content of the report.
- 29 To help manage the business of the governing body, it is suggested that the annual report becomes the summary document explaining the work of the audit committee during the course of the year and sets out how the committee has fulfilled its responsibilities set out in the mandatory minimum terms of reference in the Interim Code. The annual report may be expanded to cover other terms of reference added by the governing body.

30 Section 4 of this guidance outlines the process, principles and thinking which audit committees may wish to adopt in preparing their annual report.

Other points to note

- 31 Minimum terms of reference for the IAS – to be adopted by audit committees and important to bear in mind when putting the service out to tender. Audit committees should ensure that compliance with these forms part of the engagement letter.
- 32 Minimum content of the annual IAS Report, particularly the wording of the annual opinion and possible qualifications.
- 33 Tendering arrangements have been simplified. There is no longer the requirement to tender internal and financial statements audit services on merger or over a set period of time. The decision whether to put out to tender should be based on a review of the performance of the incumbent auditors (see paragraph 25 above also) and/or the college’s own procurement rules and financial regulations. The Interim Code also includes details of information to be sent to the LSC.

Annex D,
Supplement B

paragraphs 7–9,
Annex E, Supplement B

paragraphs 82–86,
Supplement A

paragraph 83,
Supplement A

Information to be forwarded to the LSC

- 34 Serious weaknesses, significant frauds, major accounting and other control breakdowns must be reported to the LSC’s national chief executive without delay. Serious fraud is usually where one or more of the following factors is involved:
 - a the sums of money are in excess of £10,000;
 - b the particulars of the fraud are novel, unusual or complex; or
 - c there is likely to be great public interest because of the nature of the fraud or the people involved.
- 35 Information which must be reported to the Head of PFA at the local LSC:
 - a Annual IAS report (by the deadline date set for the submission to the LSC of the annual financial statements);
 - b financial statements auditor’s interim and final management letters – note, some audit providers will do this for a college, but check, as it is the college’s responsibility to ensure that it is done;
 - c tender proposals and engagement letters for the provider(s) that the college intends to appoint as auditors;
 - d details of a significant change of audit service provider;
 - e disagreement over the level of internal audit resources;
 - f gaps in the audit service; and
 - g resignation statements of auditors.

paragraph 105,
Supplement A

paragraph 66,
Supplement A

paragraph 78,
Supplement A

paragraph 83,
Supplement A

paragraph 86,
Supplement A

paragraph 53,
Supplement A

paragraph 82,
Supplement A

paragraph 90,
Supplement A

Table 1 Minimum Cycle of Audit Committee Business (adapted to include risk management from the January 2003 Interim Audit Code of Practice)

| | Current year item of business | Indicative timings (✓) | | | | | | | | To recommend to the governing body for approval | |
|----|---|------------------------|------------------|------------------------------|------------------|------------------|--------|--------|------------------|---|--------|
| | | Previous year | | Current year | | Next year | | Spring | Autumn | | Spring |
| | | Summer | Autumn | Autumn | Spring | Summer | Autumn | | | | |
| 1 | Appointment and reappointment or dismissal (where applicable) and remuneration of internal auditors | ✓ or autumn term | ✓ or summer term | | | | | | | Yes | |
| 2 | Internal audit needs assessment, strategic plan and annual plan | | ✓ | | | | | | | Yes | |
| 3 | Risk management annual report from college management | | | | | ✓ or aut term | | | ✓ or sum term | Yes | |
| 4 | Appointment and reappointment or dismissal (where applicable) and remuneration of Financial Statements Auditors | | | | ✓ or summer term | | | | | Yes | |
| 5 | Review of performance of the IAS and establishment of annual performance indicators for next year | | | | | ✓ or autumn term | | | ✓ or summer term | No | |
| 6 | Funding Auditor interim opinion and management letter | | | | | | | | ✓ • | Yes * | |
| 7 | IAS annual report | | | | | | | | ✓ • | Yes * | |
| 8 | Financial statements audit management letter | | | | | | | | ✓ • | Yes * | |
| 9 | Annual report of the audit committee | | | | | | | | ✓ | Yes * | |
| 10 | Recommendation of approval to the governing body of annual financial statements (<i>may be the role of the finance committee or equivalent</i>) | | | | | | | | ✓ | Yes | |
| 11 | Funding Auditor final opinion and management letter | | | | | | | | | Yes | |
| 12 | Review of performance of the Financial Statements Auditors and establishment of annual performance indicators for next year | | | | | | | | | No | |
| 13 | Internal audit reports on reviews and progress update | | | Depends on timing of reports | | | | | | No | |
| | | | ✓ | | ✓ | | | | | | |
| 14 | Consideration of Funding Auditor franchise and partnership spot check reports (where applicable) | | | Depends on timing of visits | | | | | | No | |
| | | | ✓ | | ✓ | | | | | | |
| * | Governing bodies must have all these reports (items 6, 7, 8 and 9) available before approving the financial statements and the statements included therein on Corporate Governance, Responsibilities of Members of the Corporation and the System of Internal Control. The governing body must approve the annual financial statements to meet LSC deadlines. | | | | | | | | | | |
| • | Items 6, 7 and 8 may be deferred until the spring term but see comment above. | | | | | | | | | | |

Section 3: Assessing the Performance of Auditors

- 1 Audit committees have an important role to play in advising the governing body on the quality, rigour and appointment of auditors. To do this effectively, audit committees need to monitor the performance of the incumbent audit providers at least annually against their engagement letters. These engagement letters form part of the contract between the college and audit provider, setting out all the audit arrangements and obligations of each party.
- 2 The requirement for audit committees to undertake an annual assessment of the IAS and financial statements auditor was included in the FEFC Audit Code of Practice. The FEFC Code also included a suggested list of performance indicators from which college audit committees could select those most appropriate to their circumstances and needs.
- 3 The Interim Code maintains the requirement for an annual assessment, but at the same time suggests this be extended to include the assessment of the funding auditor. This extension, however, is not a mandatory requirement (also see paragraph 25 in Section 2 on page 10).
- 4 The Interim Code includes the minimum compliance and performance requirements for internal audit providers (Annex D, Supplement B). Colleges should review their arrangements against these.
- 5 For financial statements audits, the LSC issues annually a model engagement letter, which financial statements auditors are required to adopt with colleges. The 2002-03 model will include the minimum performance requirements expected from these auditors.
- 6 The LSC intends to publish separately, in due course, on the PFA section of its website (www.lsc.gov.uk), lists of these compliance questions for both internal audit and financial statements audit for colleges to use if they wish.
- 7 The need for audit committees to have general performance indicators, separate from the compliance questions mentioned above, is to aid the appraisal of the performance and value of audit work. Responses to indicator questions will also help governing bodies make a decision on the re-appointment each year of the incumbent audit provider. Measures and indicators may be applied to particular activities or reviews within audit or to the function as a whole. Although single indicators or groups of measures and indicators may be used to appraise specific aspects of output and performance, evaluation of an auditor's overall performance and value of audit work is best achieved by analysis of the results arising from all the measures and indicators that have been selected. There are a number of ways of using these indicators; the following examples provide only one such suggested way, and colleges should take an approach that suits their needs best.
- 8 The questions applicable to all audit providers at page 16 of this guidance develop the list of indicators originally provided by the FEFC, and act as a further means by which audit committees can bring rigour to the review process. This should enable a conclusion to be reached on the quality, effectiveness and value for money that colleges receive from their incumbent auditors. The checklist is not intended as a 'tick box' approach, nor is it mandatory, but instead emphasises the need for objective judgements being applied in relation to each question raised.
- 9 The LSC funding audit indicators at page 15 of this guidance covers the matters identified by the LSC upon which funding auditors are required to obtain feedback from colleges. They are likely to do this through the use of an annual client satisfaction survey,

and individual funding auditors might add additional questions to the list. College audit committees might, however, wish to use this list to provide an objective basis upon which to comment separately to the LSC on the quality of the funding audit service received.

- 10 If colleges wish to provide direct feedback to the LSC on the funding audit process or the performance of their funding auditors, they may contact the LSC ILR Contract Manager at the LSC national office.

LSC Funding Audit Performance Indicator Questions

Professionalism of the audit

Please tick

- Q1 Was the college able to negotiate on the dates of the audit? Yes No
- Q2 Have the Funding Auditors responded quickly to correspondence and telephone calls during the year? Yes No

Audit arrangements

- Q3 Was the audit process fully explained and did the college understand each stage? Yes No
- Q4 Did the audit run on time to enable finalisation of reports for college purposes? Yes No
- Q5 Does the college consider that it received timely management letters at each stage of the audit? Yes No

Accuracy and usefulness of findings

- Q6 Were the findings/recommendations fully discussed with college management before reports were drafted? Yes No
- Q7 Were the findings/recommendations accurately drafted and did the college agree with them? Yes No

The funding auditor's knowledge and understanding of the audit approach and funding methodology

- Q8 Have the funding auditors responded to queries on the audit process and funding methodology on a timely basis? Yes No
- Q9 Was the college satisfied with the knowledge and expertise of the funding auditors? Yes No

The effectiveness of liaison between funding auditors, internal auditors and financial statements auditors

- Q10 Did the funding auditor liaise with the internal auditors, and was this effective? Yes No
- Q11 Was the liaison between your funding auditor and financial statements auditor effective? Yes No

Perceived consistency of approach

- Q12 Is the college aware of any inconsistencies concerning the audit approach to your college compared with other similar colleges? Yes No

Response prepared by:

General Qualitative Performance Indicator Questions Applicable to all Audit Providers

Please indicate your satisfaction rating by placing a tick (✓) in the relevant box alongside each question.

| Satisfaction rating | | | |
|--------------------------|--------------------------|--------------------------|--------------------------|
| High | | Low | |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 1 | 2 | 3 | 4 |

Independence and objectivity

Q1 Has the auditor provided information about its policies and processes for maintaining independence and has this covered:

a the rotation of audit partners (or equivalent)?

b the nature of any other services provided to the college?

Audit strategy

Q2 Was the audit work planned with college management in a timely and appropriate way?

Q3 Did the auditors communicate to the audit committee and college management at the start of the audit where relevant:

a the audit plan?

b terms of reference?

c the audit approach?

d the level of audit materiality adopted for the audit, and justification for this amount where applicable?

e the timetable for the audit and for oral and written reports to the audit committee?

f the extent of any reliance to be placed by the auditors on the work of other auditors?

g the approach to tracking and reporting on the implementation of recommendations from previous visits?

The audit approach

Q4 Was there appropriate liaison with the college's other auditors where necessary?

Q5 Was the audit work carried out on the agreed dates and to the agreed plan?

- Q6 Did the audit team comprise staff of sufficient seniority, experience and expertise?
- Q7 Was there appropriate staff continuity from previous visits?
- Q8 Did the auditors appear to be conversant with the requirements of the LSC and any other laws, regulations and standards?
- Q9 Was the college informed of any material events during the course of the audit?

Conclusion and reporting of the audit

- Q10 Were written reports clear, concise and delivered on time?
- Q11 Were the recommendations in draft reports accepted?
- Q12 Were the recommendations considered constructive in improving the college’s control environment and were they also considered practical and effective?
- Q13 Did the auditors adequately consider the appropriateness and effectiveness of the college’s risk management processes, and were any recommendations for improvement considered to be practical and effective?
- Q14 Did the auditors attend audit committee meetings and deal with queries raised at the committee adequately?
- Q15 Did the auditors discuss with the audit committee any areas for improvement in their audit approach?
- Q16 If any audit report resulted in a qualified opinion, were the issues of concern and the impact on the report discussed with college management and the audit committee at a sufficiently early stage?
- Q17 Has there been a good working relationship between the auditors, college management and the audit committee?
- Q18 Has the auditor been sufficiently thorough in approach and robust in dealing with college management and staff?
- Q19 Have college staff provided positive feedback on the quality of the audit work?
- Q20 Were ad hoc queries during the year adequately dealt with?
- Q21 Is it recommended that the incumbent audit provider be re-appointed for the forthcoming year? Yes No

Response prepared by:

Section 4: Model Text for the Annual Report of the Audit Committee

Introduction

- 1 There is a new requirement in the Interim Code which states that the annual report of the audit committee is to be written for both the governing body *and the principal as the accounting officer for the college*. This follows practice in the higher education sector, and also recognises the value that accounting officers will place on the content of the report.
- 2 To help manage the business of the governing body, it is suggested that the annual report becomes the summary document explaining the work of the audit committee during the course of the year. This should explain how the committee has fulfilled the responsibilities set out in its terms of reference, attaching various reports as appendices. The annual report should be prepared as early as possible after the year end, after the internal audit annual report has been received, so that it is available to the governing body for consideration at the time the annual financial statements are signed. The annual report may be considered by the governing body in either the autumn or the spring term, depending on the timing of consideration of the annual financial statements. The report should be signed and dated by the chair of the audit committee.
- 3 The level of detail in the annual report should reflect the outcomes of audit work at the college. Where significant issues are identified by the auditors and/or the audit committee, more detail should be given. Conversely, colleges with few audit issues might wish to prepare a reduced version of the annual report, concentrating on summarising the key points and setting out the conclusion and recommendations.
- 4 The model overleaf is a suggestion of the contents required of a comprehensive report for a college with significant audit issues. It is based on the suggestion also of using the annual report as an 'executive summary' of all the issues, with various reference documents attached as appendices. However, the documents listed as appendices may be presented to the governing body as reports in their own right and in which case, there would be no need to include them as appendices to the annual report. The suggested model text is as follows.

Introduction

- 1 Title – full name of college, Audit Committee Annual Report, year (for example, 2002-03), addressed to the governing body and the Principal and Chief Executive.
- 2 Introduction – period covered; this should specifically relate to the audit committee's work in the financial year when the work was carried out. However, any additional information should be given where appropriate, for example where the previous year's annual report could not include something because of timing, or something has occurred which requires special treatment.
- 3 Membership of the audit committee, highlighting changes – names, date of appointment to the committee. Identify chair (and vice-chair if applicable); also separately give details of the clerk to the committee.
- 4 Meetings – dates of meetings and whether there was a quorum throughout.
- 5 Terms of reference for the Committee (attached as Appendix 1), highlighting any changes agreed by the governing body in the year (or needing to be made).

Main body

- 6 Names of each audit provider (the IAS, financial statements auditors and funding auditors), lengths (or periods) of each provider's respective appointment with the college, details of any changes made or due, fees/remuneration basis (where applicable).

Internal audit

- 7 Strategy, scope and objectives of the work of the IAS.
- 8 Summary of each internal audit assignment undertaken in the year, title and brief details of coverage, management's response to any recommendations made and audit committee's view of these, details of any recommendations outstanding, also include table of budget and actual number of days attributed to each assignment.
- 9 Review of unplanned or special reports, title and brief details of coverage if applicable, audit committee's view of management responses to the findings and recommendations, details of any significant recommendations outstanding.
- 10 Review of value for money studies, summary of important findings and recommendations.
- 11 Progress on the implementation of recommendations outstanding from previous years.
- 12 Review of the IAS annual report (attached as Appendix 2), achievement of planned work, consideration of and comment on overall IAS opinion.

Financial statements audit

- 13 Summary of the financial statements (full copy of statements attached as Appendix 3); for example, year-end out-turn, key variances from original budget for

the year, achievement of funding targets. (To be included only if the governing body has previously decided to approve the financial statements on the advice of either the audit committee or the audit committee and the finance committee).

- 14 To highlight from the financial statements the governing body's (or members') responsibilities and significant issues in the corporate governance statements (to be included irrespective of whether the finance committee recommends the financial statements or not).
- 15 Scope and objectives of the work of the financial statements auditor and a review of the significant issues in the management letter (attached as Appendix 4); management's response to any recommendations made and audit committee's view of these.
- 16 Comment on the overall opinion provided by the financial statements auditor.

Funding audit

- 17 Summary of the significant issues in the funding auditor spot checks, interim and final management letters (attached as Appendix 5); also whether the work of the funding auditor can be relied upon for internal audit purposes, management's response to any recommendations made and audit committee's view of these.
- 18 Comment on the overall opinion provided by the Funding Auditor. Note: for 2002-03 there will be three opinions: one on controls (given in the management letter); another on the interim claim; and one on the final claim.

Risk management

- 19 Summary of the committee's consideration of the college's risk management strategy and annual risk management report to the audit committee.

Other matters

- 20 Summary of any other work done, for example, LSC reports, National Audit Office reports, value for money work, and so on, or by any of the incumbent auditors, or reports by auditors working in related areas, for example the European Social Fund (ESF) or with Jobcentre Plus.
- 21 Any other relevant matters (particularly, investigations into any fraud or irregularity).
- 22 Work-based learning reviews (where applicable).
- 23 Issues arising from accounts and audits of joint ventures, subsidiary or associated companies.
- 24 Issues not relevant to the reporting year, issues relating to previous years, recommendations not dealt with elsewhere in the report.

Performance indicators

- 25 Review of the performance indicators for the audit services (attached as Appendix

6), recommendation of annual re-appointment of the IAS and financial statements auditor (can be deferred to next meeting if timing is not appropriate).

Conclusion and recommendations

- 26 Any common themes emerging from the work of the college's auditors.
- 27 The audit committee's opinion to the governing body on the adequacy and effectiveness of the 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). Note: this opinion should be based upon the information presented to the committee. The committee should also consider whether the governing body's responsibilities, included in the annual financial statements, have been satisfactorily discharged.
- 28 Recommendation of the financial statements to the governing body for approval (*if applicable*).
- 29 Date and signature of audit committee chair.

Appendices

Appendix 1: Audit Committee Terms of Reference

Appendix 2: Annual Internal Audit Report

Appendix 3: Financial Statements (if applicable, where the audit committee is recommending these for approval by the governing body)

Appendix 4: Financial Statements Audit Management Letter

Appendix 5: Funding Auditor interim (or final, whichever is applicable) opinion and Management Letter

Appendix 6: Performance Indicators

Notes

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