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Supplement D to the Regularity Audit Framework: Model Letter of Engagement for College Financial Statements and Regularity Audit

2006

Model College Financial Statements and Regularity Audit Engagement Letter

To: The College Governing Body
The Learning and Skills Council

Dear Sirs

Letter of engagement for the audit of financial statements and reporting on regularity

1. The purpose of this letter is to set out the basis on which we act as auditors (undertaking both financial statements and regularity audit) to [Name of College] ("the College") (and its subsidiaries) and the basis on which we will provide reports to the College and the Learning and Skills Council ('the LSC'). The letter reflects the requirements of the LSC's Audit Code of Practice ('the Code') set out in Circular 04/07.
2. This letter establishes an agreement between ourselves and the College in relation to the audit and reporting of the college's financial statements, and a tripartite agreement between the College, the LSC and ourselves for the purpose of reporting on regularity only. To the fullest extent permitted by law, we disclaim any duty of care to the LSC for our audit of the College's financial statements and the LSC accepts this.

FINANCIAL STATEMENTS AUDIT

Audit Scope

3. We shall conduct our audit of the college's financial statements in accordance with approved auditing standards issued by the Auditing Practices Board (the APB) and in full compliance with any instructions, guidance or framework issued by the LSC.
4. The nature and extent of our procedures will vary according to our assessment of the college's accounting system, and where we wish to place reliance on it, the internal control system. Our procedures may cover any aspect of the college's operations that we consider appropriate.
5. As part of our normal audit procedures, we may request the college to provide written confirmation of certain oral representations that we have received from the college during the course of the audit on matters having a material effect on the financial statements.
6. We shall review the working papers of the college's internal audit service, to the extent that we propose to rely on the work of the internal auditors.
7. The LSC will issue a certificate each year confirming the amount of recurrent grant-in-aid funding to be included within the college's financial statements. We intend to rely upon that certification subject to our assessment of the third

party evidence (i.e. the evidence provided by the LSC). We are not required to audit the underlying LSC funding claims (including consideration of non-eligibility of provision or learner non-existence) when forming our opinion on the financial statements.

Responsibilities of the College

8. The governing body shall be responsible for ensuring that:
 - a. A system of controls, financial and otherwise, is established and maintained in order to carry on the operations of the college in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure, as far as possible, the completeness and accuracy of the records (“the whole system of internal control”);
 - b. Proper accounting records are maintained;
 - c. Financial statements are prepared that:
 - i. comply with the college’s articles of government, all relevant statutory requirements, the financial memorandum between the LSC and the college, the Statement of Recommended Practice on Accounting for Further and Higher Education, the LSC’s accounts directions and any other regulations relevant to the constitution and activities of the college;
 - ii. show a true and fair view of the college’s financial position and of the income and expenditure for the year taking into account where relevant, disclosure requirements, and the requirements of relevant accounting standards applicable in the United Kingdom, in particular: Statements of Standard Accounting Practice, Financial Reporting Standards and other accounting standards recommended by the Accounting Standards Board (or its predecessor the Accounting Practices Committee);

Audit Reporting

9. We shall make reports to the governing body on the financial statements examined by us. Copies of reports are to be laid before the governing body during our tenure of office. Our reports shall state whether in our opinion the financial statements show a true and fair view of the college’s financial position and of the income and expenditure for the year and whether they have been properly prepared in accordance with relevant disclosure requirements, and the requirements of relevant accounting standards applicable in the United Kingdom.
10. In arriving at our opinion we are also required to consider the following matters, and to report on any aspect of which we are not satisfied whether
 - a. Proper accounting records have been kept by the college;
 - b. The college’s balance sheet and income and expenditure account are in agreement with the accounting records;
 - c. We have obtained all the information and explanations which we consider necessary for the purposes of our audit;

- d. The information given in the report of the governing body is consistent with the financial statements.
11. We have a professional responsibility to report if the financial statements do not comply in any material respect with applicable accounting standards and the requirements of the LSC, unless in our opinion the non-compliance is justified in the circumstances. In determining whether or not the departure is justified, we will consider whether:
- a. The departure is required in order for the financial statements to give a true and fair view; and
 - b. Adequate disclosure has been made concerning the departure.
12. We shall report by way of management letter to the governing body, through the audit committee, in accordance with the agreed audit timetable. The management letter shall include any significant matters arising out of the audits that we believe should be brought to the attention of the governing body and which might, for example, lead to material errors or impact on future audits, or where, for example, economies could be made, or resources used more efficiently. It shall also recommend improvements, particularly in the following areas:
- a. Weaknesses in the structure of accounting systems and the whole system of internal control;
 - b. Deficiencies in the operation of accounting systems and the whole system of internal control including, where appropriate, the college's internal audit service;
 - c. Inappropriate accounting policies and practices;
 - d. Use of funding is considered to be irregular or could be a subject of public concern;
 - e. Non-compliance with legislation, accounting standards, other regulations and LSC requirements; and
 - f. Matters raised in previous management letters where remedial action remains incomplete.

Irregularities, including Fraud

13. Ensuring the establishment and maintenance of an adequate system of internal control is the responsibility of the governing body with whom rests also the responsibility for ensuring compliance with statutory and other regulations, including those in relation to taxation, and for the prevention and detection of irregularities, including fraud and corruption. We will discuss with college management, prior to the audit, their views on where risk of fraud exists and the procedures that the college adopt to minimise the risk of fraud occurring. The matters identified by the college will be taken into account when planning our audit work.
14. We shall plan and conduct our audit so that we have a reasonable expectation of detecting material misstatements in the accounts, and identifying material improper use of funding, resulting from irregularities, including fraud or corruption, or breach of regulations. However, we are not

required under this letter of engagement to search specifically for impropriety, irregularities and fraud and corruption and our audit work should not therefore be relied on to disclose them. We shall report to the LSC's chief executive, copied to the local LSC's executive director, without delay, any serious weaknesses, significant frauds, major accounting and other control breakdowns of which we become aware subject to the requirements of the Proceeds of Crime Act 2002.

Review of Corporate Governance Disclosures

15. For the purpose of reviewing corporate governance disclosures, we shall treat the college as analogous to a listed company. Accordingly, our work shall be carried out having regard to the guidance published in Bulletin 2004/3 *The Combined Code on Corporate Governance: Requirements of Auditors under the Listing Rules of the Financial Services Authority* (and any further relevant applicable guidance which may subsequently be issued by the APB) which, among other things, shall set out the scope of our review. The LSC's interpretation of the Listing Rules requires that the auditors before publication must review the college's corporate governance statement only insofar as it relates to the relevant provisions of the Combined Code. The Listing Rules similarly require that the auditors, before publication, review the governors' statement dealing with the college's adoption of the going concern basis in preparing the financial statements. Our review shall cover only these matters. We are not required to form an opinion on your corporate governance procedures.
16. Our procedures shall primarily comprise enquiry of appropriate governors and management, and examination of documentation specified by the Combined Code. We shall consider whether the governing body's statement appropriately reflects the college's compliance with the provisions of the Combined Code in so far as they apply to further education colleges and in particular whether there is any area of non-compliance with those provisions on which we are required to report that the college has not properly disclosed. We are not and shall not be required to review the effectiveness of the college's procedures for ensuring compliance with the Combined Code, nor to investigate or comment on the appropriateness of the reasons given for any non-compliance.
17. With respect to Combined Code Provision C.2.1 (internal control) our work shall consist of:
 - a. Assessing, based on enquiry of management, the supporting documentation prepared by management for the governors and our knowledge obtained during the audit of the financial statements, whether management's summary of the process the governing body (and where applicable its committees) has adopted in reviewing the effectiveness of internal control appropriately reflects that process; and
 - b. Assessing whether the college's disclosures of the processes it has applied to deal with material internal control aspects of any significant problems disclosed in the annual report and accounts appropriately reflects those processes.

18. Our work is not designed to consider whether the governing body's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the college's risk and control procedures, our work on internal control will not be sufficient to enable us to express any assurance as to whether your internal controls are effective. Our financial statements audit should not be relied upon to draw to your attention all matters that may be relevant to your consideration as to whether your system of internal control is effective.

General Meeting

19. We shall be entitled to attend any general meetings of the governing body and to receive all notices or any other communications relating to any general meeting which any member of the governing body is entitled to receive, and to be heard at any general meeting which we attend, or any part of the business of the meeting which concerns us as the college's financial statements auditor.

REGULARITY AUDIT

Scope of our regularity audit work

20. The scope of our work and the procedures we shall carry out in preparing our report on the regularity of college expenditure will be in accordance with the Code and guidance contained with the regularity audit framework, issued by the LSC.
21. Our work will be based primarily on internal management information and will be carried out on the assumption that the information provided to us by the management of the College is reliable and, in all material respects, accurate and complete.
22. We shall review the working papers of the college's internal audit service, to the extent that we propose to rely on the work of the internal auditors.

Responsibilities of the College

23. The governing body is responsible for ensuring that the college's income and expenditure have been applied for the purposes intended by Parliament and the financial transactions conform to the authorities that govern them.

Responsibilities of the LSC

24. The LSC has issued a framework for the undertaking of the regularity audit work and will undertake a quality assurance programme over that work. The LSC will also be responsible for ensuring it discloses to us reasonable and relevant information it holds which may impact upon the planning and subsequent delivery of each audit. This will include feedback from Local Learning and Skills Councils.

Audit Reporting

25. Regularity audit reports will be sent to the Regional Audit Manager at the LSC, and to the governing body at the college. Where a management letter is produced, we will copy it to the LSC. The final regularity audit report,

covering the college's financial year, will also be included in the college's financial statements.

26. We shall prepare an interim regularity audit report unless
- the LSC has stated that it does not require one, and
 - the college governing body has made the necessary statement on regularity, propriety and compliance to the LSC.

Any such report shall (provided that our findings support this) state that in the course of our work, nothing has come to our attention which suggests that in all material respects the expenditure disbursed and income received during the period 1 August to 31 March in the relevant financial year has not been applied to the purposes intended by Parliament and the financial transactions do not conform to the authorities which govern them.

27. A model unqualified interim regularity audit report is included in the *Regularity Audit Framework* issued by the LSC. Where we are unable to express an unqualified opinion or wish to use an alternative wording to that prescribed by the LSC, we will communicate this to the governing body and to the LSC in accordance with paragraph 76 of the Code.
28. Our final regularity audit report shall (provided that our findings support this) state that in our opinion, in all material respects the expenditure disbursed and income received during the year ended 31 July have been applied to purposes intended by Parliament and the financial transactions conform to the authorities which govern them.
29. A model unqualified final regularity audit report is included in the *Accounts Direction Handbook* issued by the LSC. Where we are unable to express an unqualified opinion or wish to use an alternative wording to that prescribed by the LSC, we will communicate this to the governing body and to the LSC in accordance with paragraph 76 of the Code.

FINANCIAL STATEMENTS AND REGULARITY AUDIT

Appointment and Qualification

30. We acknowledge that the governing body will annually reconsider the reappointment of auditors. The governing body on the advice of the audit committee will fix remuneration annually. We confirm that we are qualified to be appointed as auditors for the College in accordance with the requirements of the Code.

Fees

31. Our fee in respect of the audit of the college will be agreed separately on an annual basis in line with the terms of our appointment. Part of this fee represents the LSC's consideration (payable by the College) for the regularity audit. Our fee is fully inclusive except for the addition of value added tax. Our audit fees in the future would be agreed with you annually in line with the

terms of our appointment. Invoices for our audit fees will be raised as our work progresses.

Access to documentation

32. We shall have right of access at all times to the books, accounts and vouchers of the College, minutes of the governing body and management meetings, and such information and explanations as are necessary for the performance of our duties in accordance with the Code.
33. We expect unrestricted access to the files and working papers of the college's internal audit service, and to have regular meetings with internal audit personnel. [We expect to have the right to hold meetings with the LSC's appointed funding (ILR) audit contractor as required – *optional sentence for colleges not in scope for plan led funding*]. The working papers relating to our audit are the property of [name of firm]. In the event of a request from the LSC or National Audit Office, access to regularity reporting working papers will be provided on the exchange of appropriate 'hold harmless' letters.
34. We will have the right of access to the chair of the college's audit committee and also the right to require the chair to convene a meeting, if necessary, with, or without other participants.

Other Work

35. We may also be asked from time to time to provide additional services, including value for money or other investigations, beyond the scope of the audit described in this letter of engagement. Precise requirements will be agreed between the governing body and us, and set out under a separate letter of engagement. In these circumstances both the governing body and we must be satisfied that no conflict of interest could, or be perceived to, arise. The audit committee must be informed of all work undertaken by us, and where appropriate the governing body must approve additional services in accordance with paragraph 95 of the Code.
36. Fees for additional assignments, which you may commission outside the scope of the annual financial statements and regularity reporting, will be agreed with you in writing in advance of the work, together with terms of reference and an estimate of the timescale involved.

Reports to those charged with governance

37. We will agree with the audit committee, on behalf of the governing body, the timing and form of communication between the governing body and ourselves.
38. We understand that the College will provide copies of our management letters to the LSC. With the exception of this, no reports may be provided to a third party without our prior written consent. Such consent will be granted only on the basis that such reports are not prepared with the interests of anyone other than the College in mind and that we accept no duty or responsibility to any other party.

39. Where serious weaknesses or an accounting breakdown or other control breakdown is identified, it shall be reported to the Principal, the chair of the governing body, and the chair of the audit committee without delay. Such weaknesses or breakdowns shall be reported to the chief executive of the LSC, copied to the executive director of the College's local LSC.
40. We reserve the right to communicate directly with the audit committee or governing body at any time in the event that any matters come to our attention which we believe should be incorporated without delay.

Termination of Appointment

41. The governing body may by resolution remove us as the college's financial statements and regularity auditors before the expiration of our term of office, notwithstanding any agreement between the governing body and us. We, as the college's financial statements and regularity auditors, may resign before the end of our term of office. Where we cease to hold office for any reason, we will provide the governing body with either a statement of any circumstances connected with the removal or resignation, which we consider should be brought to the governing body's attention, or a statement that there are no such circumstances. The college must copy this statement to the Regional Audit Manager at the LSC, without delay.

Complaints Procedures

42. If at any time you would like to discuss with us how the services can be improved or if you have a complaint about them, you are invited to telephone [name] on [telephone number]. If your problem is not resolved, you should contact [name], our [role], either by writing to him at [firm address]. We will investigate any complaint promptly and do what we can to resolve the difficulties. If you are still not satisfied, you can refer the matter to the Institute of Chartered Accountants for England and Wales (ICAEW).

Confidentiality

43. We confirm that where you give us confidential information, we shall at all times keep it confidential, except as required by law or as provided for in regulatory, ethical or other professional pronouncements applicable to our engagement. You agree that it will be sufficient compliance with our duty of confidence for us to take such steps as we in good faith think fit to preserve confidential information both during and after the termination of this engagement. We have a professional duty to disclose, on request, our audit working papers and other relevant monitoring information to the ICAEW and its Quality Assurance Directorate, the Audit Inspection Unit of the financial reporting Council and to the LSC, subject to the arrangement in paragraph 33 above.

Electronic Communication

44. During the engagement we may from time to time communicate electronically with each other. However, the electronic transmission of information cannot be guaranteed to be secure or virus or error free and such information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete or

otherwise be adversely affected or unsafe to use. We recognise that systems and procedures cannot be a guarantee that transmissions will be unaffected by such hazard.

45. We confirm that we each accept the risks of and authorise electronic communications between us. We each agree to use commercially reasonable procedures to check for the most commonly known viruses before sending information electronically. We shall each be responsible for protecting our own systems and interests in relation to electronic communications and the college and [name] (in each case including our respective partners, employees, agents or officers) shall have no liability to each other on any basis, whether in contract, tort (including negligence) or otherwise, in respect of any error, damage, loss or omission arising from or in connection with the electronic communication of information between us and our reliance on such information.
46. We acknowledge that the governing body may wish to publish the financial statements of the college, including the regularity report, on its web site. As members of the governing body you are required to ensure that any such publication properly presents the financial information and the auditors' report. The governing body will advise the auditors in advance of any intended electronic publication before it occurs. As auditors we reserve the right to withhold consent to the electronic publication of our report if the audited financial statements or the auditors' report are to be published in an inappropriate manner. As members of the governing body, you are responsible for the controls over, and the security of, the web site. Any examination of such controls is beyond the scope of our audit.

Applicable Law

47. This engagement letter shall be governed by, and construed in accordance with, English law. The courts of England shall have exclusive jurisdiction in relation to any claim, dispute or difference concerning the engagement letter and any matter arising from it. Each party irrevocably waives any rights it might have to object to an action being brought in those courts, to claim that the action has been brought in an inconvenient forum, or to claim that those courts do not have jurisdiction.

Agreement of Terms

48. If the contents of this letter are not in accordance with your understanding of the arrangements made, all parties shall be pleased to receive observations and to give any further information required. Please confirm, by signing below, your agreement to this engagement letter. Once signed, this letter should be sent to the Regional Audit Manager at the LSC for signature and will then form a contract between the College and this firm in respect of the financial statements audit, and a separate tri-partite contract between each of the parties in respect of the regularity reporting, a copy of the letter being held by each party.
49. In addition to the above, our Terms and Conditions of Business are attached. They further include and explain certain of the definitions and detail used in

this letter and form part of this Engagement letter. In the event of a conflict between the terms of this letter and the Terms and Conditions of Business this letter shall prevail.

50. Clause X [*this will be the clause referring to limitation of liability*] of our Terms and Conditions of Business sets out here the principal exclusions and limitations on our liability. Notwithstanding anything to the contrary in that clause our liability to the governing body in connection with our financial statements audit for losses shall be unlimited. Our liability to the governing body and the LSC in connection with our regularity reporting for losses shall be [*unlimited or limited to a maximum aggregate of X times our combined fee for the audit and regularity reporting/limited to £XX million or to a calculation based on a minimum level of liability plus one third of the excess of the transaction value over £1million up to maximum total limit of aggregate liability of £XX million*].

[Any proposal to limit the firm's liability to the LSC must be agreed in advance with the LSC's solicitor through the regional audit manager.]

Yours faithfully

[name of accountant]

On behalf of the governing body of [Name of college] I confirm the above terms.

Signed

Name

Position

Date

On behalf of the Learning and Skills Council I confirm the above terms.

Signed

Name

Position

Date

If the college is one of a small number of designated colleges that are also limited companies, these paragraphs should be inserted:

After paragraph 5

In connection with the representations and the supply of information to us generally, we draw your attention to section 389A of the Companies Act 1985 under which it is an offence for an officer of the company to mislead the auditors.

After paragraph 9

In preparing our report it is our duty to carry out such investigations as will enable us to form an opinion as to whether:

- a. the college's financial statements are in agreement with the accounting records;
- b. the financial statements have been properly prepared in accordance with the Companies Act 1985.

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