

i For information



Leading learning and skills

Supplement E to the Regularity Audit Framework: Some Questions and Answers

2006

Some Questions and Answers

Introduction

- 1 In this document, academic years to 31 July are shown as 200x/0y. Financial years to 31 March are shown as 200a-0b.

Why is regularity audit being introduced?

- 2 The Learning and Skills Council (LSC) is introducing regularity audit as a result of three major changes:
 - Success for All and plan-led funding
 - reducing bureaucracy
 - faster closure.

Each of these is discussed below.

Success for All and plan-led funding

- 3 The LSC in its relations with further education (FE) colleges has been moving away from pure payments-by-results used by the Further Education Funding Council (FEFC) to a strategic relationship. For 2004/05 onwards, this has meant for most FE colleges that their funding is no longer directly linked to the value of delivery recorded on their individual learner record (ILR). Instead, funding is negotiated between the LSC and FE colleges. Funding audit (also sometimes known as ILR audit) was an essential and integral part of payment-by-results but is not required under plan-led funding. With funding audit being phased out, the LSC has moved to standardise the existing regularity audit for most FE colleges. The new framework for regularity audit will become, along with the work of colleges' internal audit services, the mainstay of the LSC's assurance over FE colleges' use of LSC funds.

Reducing bureaucracy

- 4 The LSC has worked closely with the Bureaucracy Busting Task Force and more recently with the Bureaucracy Review Group. Both these forums highlighted the level of audit, and funding audit in particular, as something the LSC should seek to reduce while maintaining proper accountability for public funds.

Faster closure

- 5 This initiative by HM Treasury applies across the public sector. It requires public bodies to submit their audited financial statements to Parliament by the parliamentary summer recess following the March financial year-end. The LSC has to comply with this requirement. A key part of the LSC's own financial statements is reporting on the use that learning providers, including FE colleges, have made of LSC funds. Most of the evidence of this use of funds came from the funding audit. As the funding audit reported to 31 July, it could never meet this requirement. At the same time, the LSC has been tasked by the National Audit Office (NAO), the LSC's own financial statements auditors, to base the LSC's

financial statements on timely evidence of providers' use of funds up to the 31 March year-end. Again, the funding audit report could not do this.

- 6 The LSC therefore required all colleges, for 2004/05, to commission an interim regularity audit from their financial statements auditors, to give the LSC assurance over the use of its funds by colleges for the period to March 2005. The NAO has since confirmed that this interim regularity audit can be dispensed with for any college provided that the LSC is satisfied that the college has sufficiently robust systems to identify material irregularity and inform the LSC of it. This framework has therefore been revised for 2005/06 onwards to recognise that the interim regularity audit report is only required from some colleges.

Who does regularity audit apply to, and when?

- 7 Regularity audit is not a new requirement, since all FE colleges have been subject to it since 1993-94. The new regularity audit framework applies to all FE colleges for 2004/05 onwards. Other LSC-funded learning providers may also be subject to other regularity audit regimes not covered by this document.

Is regularity audit a new requirement?

- 8 No, it has been in place since 1993-94 for all FE colleges. All FE colleges have had a regularity audit opinion since then.

Why is a new regularity audit framework needed now?

- 9 Funding audit, and the work of colleges' internal audit services, were until 2003/04 the mainstay of FE colleges', and the LSC's, assurance over the use of LSC funds. Until 2003/04, the LSC had very little involvement in regularity audit, leaving it wholly to college financial statements auditors to decide what work they would do in giving their opinion. The LSC did not know to what standard regularity audit was being conducted.
- 10 With funding audit removed from most FE colleges, the LSC has decided that for the time being, it will issue a regularity audit framework. This framework, which was introduced for 2004/05, sets out the LSC's recommendations to FE colleges, and their financial statements auditors, as to what the regularity audit opinion should be based on. The LSC will review the need for this framework in the light of how well regularity audit is performed.

What about FE colleges that are not in plan-led funding?

- 11 Some 45 FE colleges were not in plan-led funding for 2004/05. These FE colleges were still subject to the new regularity audit framework for 2004/05. The LSC has decided to include all FE colleges in the new framework so that the FE colleges have a year's notice of meeting the faster closure timetable for summer 2006.
- 12 All FE colleges that are not in plan-led funding will continue to be subject to a funding audit commissioned and paid for by the LSC. The funding audit for 2004/05 will follow similar principles, objectives and practices as

the funding audit for 2003/04. The funding audit will take full account of changes to the LSC's funding methodology for 2004/05.

What is regularity audit?

- 13 The LSC funds FE colleges under grant-in-aid, a special form of funding agreement used in Government. Grant-in-aid funding includes the parliamentary expectation that LSC, and hence public, funds will be used with regularity and propriety. 'Regularity' means that the funds are used in accordance with the LSC's and the FE colleges' statutory and other duties. 'Propriety' means that public funds are used in a way that is expected of public servants, avoiding personal gain, extravagance or unreasonable expenditure. As noted above, the LSC and the FEFC before it have had this requirement of FE colleges since 1993/94.

Does the regularity audit framework require detailed annual work on key financial controls at the college?

- 14 No. The regularity audit framework presupposes that colleges have a sound framework of internal control. The framework also presupposes that regularity auditors will seek to rely on the work on key financial systems and other areas carried out by colleges' internal auditors. The responsibilities of colleges' internal auditors are set out in the LSC's Audit Code of Practice (the Code), published with Circular 04/07.
- 15 Annex C to the Code sets out business areas which must be included within colleges' internal audit annual and strategic (that is, over a three to five year period) plans. The business areas to be included in internal audit strategic plans include:
- Financial planning, budget setting, monitoring and forecasting
 - Fundamental financial accounting and asset controls
 - Procurement and payments
 - Learner number systems and funding claims.
- 16 Regularity auditors should seek to rely on internal audit work undertaken in these (and other) business areas. Where this work was undertaken in previous years, regularity auditors may seek confirmation that key financial controls continue to operate and the framework of internal control has not changed. Where internal audit work on these business areas is included within the internal audit strategic plan, but has not yet been undertaken, regularity auditors may seek to perform limited additional work on key financial controls. Alternatively, internal auditors may, at the request of the college audit committee, bring forward the timing of this work. The scope and timing of all audit work should be discussed and agreed annually by the college audit committee, financial statements auditors and internal auditors. A key aim of this discussion is to minimise duplication and overlap of coverage by the respective auditors. Guidance on this is included in the HM Treasury booklet *Co-operation between Internal and External Auditors: A Good Practice Guide* (available online at http://www.hm-treasury.gov.uk./media/8B9/07/auditors_190105.pdf).

How does regularity audit differ from funding audit?

- 17 Funding audit established whether the FE college had earned what the LSC had paid the college under the LSC's agreed allocation to the college. The FE college's earnings were for individual components of each learner's learning and support experience at the college. FE colleges recorded these individual components on the ILR and many had a financial equivalent. The total of these financial components was the college's funding claim, against its allocation, to the LSC. Funding audit examined FE colleges' controls over the systems that recorded the ILR and put the claim together, and sample-tested some of the transactions on the ILR or funding claim, when cost-based. The funding audit was necessarily complex as it reflected the LSC's FE funding methodology, which was also complex. The funding audit had to pay attention to most of the LSC's detailed funding rules, which when not observed led to financial penalties.
- 18 Regularity audit is about how the college has spent LSC, and other, funds. It is about the activities the college engages in and whether these are within statutory and other duties and within expectations of stewardship of public funds. Regularity audit does not have to examine the whole set of the LSC's funding methodology as the LSC is no longer holding FE colleges to account for all transactions with a financial equivalent in the ILR every year. Regularity audit will involve some review of controls and testing, but this can be far more limited than funding audit as it is based on much more broad-based activities.
- 19 Regularity audit is not however in any way about stopping colleges from activities that are within their legal powers.

What is the scope of regularity audit?

- 20 All FE college expenditure, funded from whatever source, is included in regularity audit. This has probably been the case since 1993/94 and was confirmed in a series of Public Accounts Committee (PAC) hearings in the late 1990s into the activities in the mid-1990s of several higher education (HE) institutions and one FE college. The PAC made no distinction between institutions' and FE colleges' sources of funds in its consideration of what funds had been spent on.

Who is responsible for the use of LSC and other funds colleges receive?

- 21 As since 1993/94, FE college corporations and their principals have responsibilities under statute for their activities. FE college principals are also the FE colleges' accounting officers and may be required to appear before the PAC in their own right. The LSC wishes to stress that the new regularity audit framework does not displace any of these responsibilities. Instead, under the Trust in FE agenda, the LSC sees FE colleges as increasingly responsible in their own right for their activities. Traditional means of review and control, such as audit, are less important in this developing relationship.

Who decides what is regular and proper?

- 22 FE college governors and managers have their own responsibilities for securing regularity and propriety. In the first instance, it is for them to assess the risks to regularity and propriety and also the actual activities the FE college undertakes.
- 23 Regularity auditors are expected to use their professional judgement to form an independent opinion on regularity and propriety. Where regularity auditors have queries about FE colleges' activities, the LSC is looking for the FE college and the regularity auditor to resolve these as far as possible.
- 24 The contacts at the end of this document will answer queries from regularity auditors or FE colleges where resolution has not been reached. However, the LSC is not expecting a significant number of such enquiries and expects to be in the position of formally arbitrating on regularity or propriety only as a last resort.

Who are the regularity auditors and who appoints them?

- 25 The LSC consulted FE colleges on this issue and the outcome is that FE colleges' financial statements auditors will continue to give a regularity opinion, as before. FE colleges appoint the financial statements auditors, and regularity auditors, in accordance with the LSC's *Audit Code of Practice* (the Code). Regularity audit will form part of FE colleges' appointment of financial statements auditors for 2004/05.

Can we extend the appointment of our current auditors?

- 26 The LSC dropped its requirement that colleges re-tender for audit services, as part of the interim *Audit Code of Practice* issued in March 2003 and this has not changed in the Code. Colleges may extend the existing appointments of auditors as they see fit. The LSC does look for rotation of the audit partner or equivalent every seven years, in line with best professional practice.

Is there a duty of care for regularity audit?

- 27 The LSC considers that auditors will have a duty of care to the LSC, and to FE colleges, for their regularity audit opinion. The regularity audit opinion is addressed to both the FE college and to the LSC.
- 28 The LSC has developed a letter of engagement between the LSC, FE colleges and their financial statements auditors to reflect this. The letter of engagement has been developed in the light of guidance from the Institute of Chartered Accountants of England and Wales (ICAEW) to its members on reports to grant-paying bodies.
- 29 When new financial statements auditors are appointed, this letter will need to be signed by the college and its financial statements auditors first and, once signed, sent to the LSC for our signature. We will then send the original letter back to the college and we will keep a copy. This is the procedure that our, and the ICAEW's legal advisers, have told us is needed.
- 30 The LSC is not however seeking a duty of care on the 'true and fair' opinion, and other opinions, on FE colleges' financial statements.

What is required and when?

- 31 The LSC requires colleges to secure an opinion on regularity from their financial statements auditors, to be published as part of the annual financial statements. For colleges that
- do not satisfy the criteria given in paragraph 18 of the regularity audit framework, or
 - which do satisfy the criteria but do not send a statement in the form at Supplement F to the LSC

the LSC also requires an interim regularity audit report on the eight months from 1 August to 31 March and to submit this to the LSC by 31 May. An interim regularity audit report is not required from other colleges but it remains the choice of the governors whether to commission one.

Who pays for regularity audit?

- 32 FE colleges already pay for regularity audit and the LSC requires them to pay for any additional work under the new regularity audit framework. This will result in some additional cost to most FE colleges.
- 33 However, the LSC is no longer paying for the funding audit of FE colleges. The cost of funding audit was previously deducted from the LSC's programme budgets for funding learning. The end of most funding audit will release a saving of several million pounds back into learning. The LSC will allocate this released funding in accordance with its priorities and needs, as with all other funding the LSC has. The LSC does not itself benefit from the savings from ending most funding audit.

How much more will regularity audit cost?

- 34 The LSC piloted its new regularity audit framework with five colleges and all of these colleges reported that, as expected, some additional work was required. This additional work was in line with the LSC's expectations of typically between four and seven additional days of regularity audit for FE colleges in 2004/05. This may reduce for future years once set-up work has been done and does not need to be repeated in full. This compares with a typical funding audit annual duration of between 20 and 50 days and the associated costs to colleges of working with auditors on site.
- 35 KPMG developed the regularity audit programme for the LSC and our understanding is that this programme reflects the work that KPMG already did in giving its regularity opinion. The LSC has made minimal changes to the programme, mostly in the area of propriety, which involves little detailed additional work. The programme itself was shared with other significant financial statements audit firms working with FE colleges and developed further in the light of their comments. Five of these leading firms were also involved in the pilot of this programme; between them, these firms serve a very high proportion of the total number of colleges. Given that the regularity audit programme is based on existing regularity audit approaches, and the programme has been validated by leading audit firms already doing this work, the LSC does

not expect audit resources to increase significantly beyond the four to seven days identified by the pilot.

When should the regularity audit take place?

- 36 As the regularity audit is performed by financial statements auditors, it would be reasonable to expect that the work is integrated with the financial statements audit, especially as the report is given alongside the financial statements. At colleges where interim regularity audit work is required, the LSC anticipates that the regularity auditor will need only to cover the four months from April to July at the final audit stage, as work on the period August to March will have been completed for the interim regularity audit report. Auditors may of course seek to do some work at an interim stage to save time at the financial statements audit in the autumn, as is common practice for financial statements audit.

What is the impact on bureaucracy?

- 37 As noted above, FE colleges and their representatives continually highlighted funding audit as one of the most significant administrative burdens they faced. One of the costs of this burden was the money that the LSC diverted from learning to pay for the funding audit, which is now being mostly released back into learning. The other cost was FE colleges' administration of the annual funding audit, which colleges have reported as having imposed significant additional costs on them. FE colleges will also be able to realise these savings.

Will there be more qualifications than before?

- 38 Regularity audit has been an annual event for FE colleges since 1993/94. Since then, there have been a tiny number of regularity or propriety issues reported by financial statements auditors to the LSC. The LSC believes that FE colleges do make regular and proper use of their funds and is not expecting a significant increase in the number of reports of irregularity or impropriety.

How does regularity audit affect college internal auditors?

- 39 FE colleges are still required to put in place an internal audit service that works in accordance with Government Internal Audit Standards. There are some common areas of interest between FE college internal audit services and regularity auditors, who should coordinate and cooperate in their work to avoid duplication. Guidance on this is included in the HM Treasury booklet *Co-operation between Internal and External Auditors: A Good Practice Guide* (available online at http://www.hm-treasury.gov.uk/media/8B9/07/auditors_190105.pdf). FE colleges should also share their regularity self-assessments and other evidence with their internal audit services.

What are the risks to FE colleges of the change?

- 40 Since the LSC announced the end of funding audit for most FE colleges, FE colleges have reviewed the assurance available to them in the absence of that audit. The funding audit is now recognised by many FE colleges as having provided the FE colleges, as well as the LSC, with

considerable assurance over the FE colleges' management information and ILR systems.

- 41 Some colleges are now considering commissioning extra work from their financial statements auditors, their internal audit service or other consultants. This is a decision for the FE college, in evaluating how to address risks identified as part of the FE colleges' risk management process. The LSC cannot say how much assurance colleges need to obtain and from what source. It is important to understand that the risks that payment-by-results funding brought have changed. Although the LSC continues to be concerned with the quality of data FE colleges submit, this data will not usually have an immediate financial effect, unless the evidence the data provides coincides with statutory or other duties. Poor-quality data will instead be one of the factors informing the LSC's wider relationship with those FE colleges in plan-led funding. The LSC sees no need for FE colleges to seek to replace, through audit they commission, all of the assurance they gained in the past from funding audit.

What do college governors need to do?

- 42 The timing of regularity audit and appointment of regularity auditors may need some changes to audit committee meetings. Most colleges will have already made these changes based on LSC advice given in May and June 2004 and confirmed at seminars held late in the summer of 2004 once the consultation on the Code was complete.
- 43 Audit committees need to take an interest in the college's regularity self-assessment. The LSC recognises that the timing of the regularity audit interim work may not allow audit committees to review the self-assessment in advance of the audit work taking place. In such cases, audit committees should receive the self-assessment retrospectively. Besides supporting the audit, the self-assessment should be very informative to governors in summarising key areas of the college's governance and risk management. Audit committees should also consider the interim and final regularity opinions and any management letter points arising from this work.

What guidance is the LSC issuing?

- 44 The LSC's *Audit Code of Practice* (the Code) sets out the LSC's requirement for the audit of FE colleges and other learning providers. The LSC issued the Code on its website (www.lsc.gov.uk) in December 2004.
- 45 The LSC is also issuing the new regularity audit framework on its website. The framework is supplemented by:
- a regularity self-assessment for colleges to complete in advance of the regularity audit work
 - the LSC's recommendations to regularity auditors on work to be done
 - the model regularity audit opinion

- a model letter of engagement between the LSC, FE colleges and regularity auditors
- these questions and answers
- guidance for college governors on the statement to be sent to the LSC if the college wishes to take advantage of the dispensation from the interim regularity audit.

What about other LSC funding of FE colleges?

- 46 As noted above, all LSC funding of FE colleges is covered by regularity audit.
- 47 Some other LSC funding of FE colleges continues to be subject to earnings accountability and necessarily is still subject to funding or other audit that is additional to regularity audit. This is principally work-based learning funding, but also includes local initiative and development (LID) funding and the European Social Fund (ESF). Where such work takes place, the financial statements auditors (as regularity auditors) should rely on this work in respect of use of funds.
- 48 In 2004/05, the LSC piloted the concept of bringing LSC funding of work-based learning at FE colleges within plan-led funding from 2005/06. If successful, this will also remove the requirement for the funding audit of this funding.

What other audit will the LSC still perform?

- 49 As noted above, some LSC funding of FE colleges will continue to be subject to funding audit in the future. Future funding streams may also require specific funding or other audits by the LSC, depending on the terms and conditions of the funding. The LSC will however strive to include assurance on future funding streams within regularity audit.
- 50 The LSC will also commission and perform a limited cyclical programme of tests of learner existence and eligibility at FE colleges. The LSC considers this necessary to address residual risk to it, and to FE colleges, of the end of funding audit.
- 51 This programme will be heavily risk-based, with low-risk colleges being tested, in a short audit visit, possibly as infrequently as every five to seven years. Low-risk colleges will be those with continuing records of successful performance and management of their data and, where FE colleges use sub-contractors, they can demonstrate a good record of control of their sub-contractors. High-risk colleges will face more extensive and frequent testing. This work is likely to be performed by audit firms appointed and paid for by the LSC or by LSC in-house provider financial assurance (PFA) staff. The LSC's programme of this work is under development and colleges will be fully involved in it.
- 52 The LSC will continue to perform its financial management and governance (FM&G) reviews, in parallel with the education inspectorates. The LSC has reviewed its approach to FM&G, and the self-assessment review questionnaire, in the light of regularity audit.

Contacts for further questions or enquiries

Steve Passmore, Regional Audit Manager (London)

Email: steve.passmore@lsc.gov.uk

Tel: 020 7904 0788

Clive Gordon, Principal Auditor (London)

Email: clive.gordon@lsc.gov.uk

Tel: 020 7904 0672

© LSC 2006

Published by the Learning and Skills Council.

Extracts from this publication may be reproduced for non-commercial educational or training purposes on condition that the source is acknowledged and the findings are not misrepresented.

This publication is available in electronic form on the Learning and Skills Council website: www.lsc.gov.uk

If you require this document in an alternative format or language, please contact the LSC Helpdesk.

LSC Helpdesk: 0870 900 6800

Publication reference: LSC-P-NAT-060223/E