



# Further Education Audit Code of Practice

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## Codes of Practice

Codes of Practice document No: 001/2007

Date of issue: 1 August 2007

# Further Education Audit Code of Practice

- Audience** Further Education institutions and their stakeholders.
- Overview** This document sets out the Welsh Assembly Government's mandatory requirements in relation to Further Education institutions' audit arrangements, which represent conditions of funding under the Welsh Assembly Government's Financial Memorandum with further education institutions, and provides guidance on good practice, effective from the 1st August 2007.
- Action required** No response required.
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<http://new.wales.gov.uk/topics/educationandskills>

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## Summary

The Audit Code of Practice (the Code), sets out the Welsh Assembly Government's mandatory requirements in relation to Institutions' (including Further Education institutions and designated Institutions) audit arrangements, which represent conditions of funding under the Welsh Assembly Government's Financial Memorandum with institutions and provides guidance on good practice for their Audit Committees and their external and internal auditors.

The Code also sets out the role and responsibilities of the Welsh Assembly Government's Provider Audit and Governance Service (PAGS) in relation to institutions and other Providers of Education and Training.

The primary purpose of this framework for audit is to provide the Sub-Accounting Officer of the Department for Children, Education, Lifelong Learning and Skills (DCELLS), as Accounting Officer for public funding received by providers of education and training providers, with independent assurance that the providers have established appropriate arrangements for internal control to ensure that the requirements of the Welsh Assembly Government's Financial Memorandum are satisfied.

Institutions are responsible for ensuring that funds from the Welsh Assembly Government are used only in accordance with the Learning and Skills Act 2000 (the Act), their Financial Memorandum with the Welsh Assembly Government and any other conditions which the Welsh Assembly Government may from time to time prescribe.

# Section 1

## Introduction

### **Background**

1.1 The Audit Code of Practice (the Code), sets out the Welsh Assembly Government's mandatory requirements in relation to Institutions' (including Further Education institutions and designated Institutions) audit arrangements, which represent conditions of funding under the Welsh Assembly Government's Financial Memorandum with institutions and provides guidance on good practice for their Audit Committees and their external and internal auditors. The Code also sets out the role and responsibilities of the Welsh Assembly Government's Provider Audit and Governance Service (PAGS) in relation to institutions and other Providers of Education and Training.

1.2 The primary purpose of this framework for audit is to provide the Sub-Accounting Officer of the Department for Children, Education, Lifelong Learning and Skills (DCELLS), as Accounting Officer for public funding received by providers of education and training providers, with independent assurance that the providers have established appropriate arrangements for internal control to ensure that the requirements of the Welsh Assembly Government's Financial Memorandum are satisfied.

1.3 Within the Code, 'must' and 'will' denote mandatory requirements and 'should' denotes the Welsh Assembly Government's view of good practice which it will look to providers to follow. The list of mandatory requirements for institutions is provided at Annex A.

1.4 The Code is primarily for the use of institutions' governing bodies, Audit Committees, internal and external auditors and senior management. The Code should be read in conjunction with any relevant publications by the Auditing Practices Board and Government Internal Audit Standards (GIAS) in relation to internal audit. More detailed advice on any aspect of the Code is available from the PAGS.

1.5 The Code is not intended to be a manual. Internal and External Audit services should develop their own audit manuals which detail specific arrangements and procedures for audit related matters.

1.6 It may be necessary, from time to time, for the Code to be updated. The Welsh Assembly Government intends to keep the operation of the Code under review and will consult interested parties before making any significant amendments.

1.7 A Glossary of Terms used throughout this Code is included as Annex M.

## **Further Education Institutions**

1.8 Institutions are responsible for ensuring that funds from the Welsh Assembly Government are used only in accordance with the Learning and Skills Act 2000 (the Act), their Financial Memorandum with the Welsh Assembly Government and any other conditions which the Welsh Assembly Government may from time to time prescribe. Institutions must ensure that they have in place appropriate risk management, control and governance processes sufficient to safeguard public funds and ensure that they are only used in accordance with the conditions under which they have been made available. In addition, institutions are responsible for securing the economic, efficient and effective management of their resources and expenditure.

1.9 Where an institution receives funds from both the Welsh Assembly Government and the HEFCW, the Code which will apply will be that derived from the body providing the greater proportion of funds to the institution. In this Code, references to funds received from the Welsh Assembly Government should also be taken to include any funds received from the HEFCW.

1.10 Institutions must keep proper accounts and accounting records and provide, in respect of each financial year, financial statements prepared in accordance with approved Sector Accounting Policies (*WAG Circular 33/2006 or its successors*) and any relevant legislation. Institutions are required to appoint external auditors to audit the financial statements in accordance with Auditing Standards and Guidelines and this Code as it relates to external audit.

## Section 2

# The Role of Audit in the Further Education Sector in Wales

### **Elements of Audit**

2.1 Institutions are required to have adequate risk management, control and governance arrangements to ensure public funds are safeguarded and used for the purposes for which they are provided. The institution is also required to have an effective system of internal control. The internal audit function provides the Governing Body with assurance on the institution's risk management, control and governance processes. There are two bodies to which institutions are accountable in this respect - Parliament, and the Welsh Assembly Government. Each of these bodies has established appropriate arrangements to safeguard its interests.

### **Parliament**

2.2 Parliament's interest is to see that public funds are properly accounted for and are used economically, effectively and efficiently by recipients. This role is formally discharged through the work of the Committee of Public Accounts. The Government of Wales Act, 1998 provided for the appointment of an Auditor General for Wales and an Audit Committee which may take evidence on behalf of the House of Commons Public Accounts Committee if requested by that Committee. The Auditor General for Wales, head of the Wales Audit Office (WAO), is the external auditor of the Welsh Assembly Government and has the right to inspect the accounts of any institution in receipt of grant and to carry out value for money exercises. The WAO are selective in their use of inspection rights; most of the financial audit work can be undertaken at the Welsh Assembly Government. Value for money studies normally involve a sample of institutions.

### **The Welsh Assembly Government**

2.3 Public funds are channelled through DCELLS and the Principal Accounting Officer of the Welsh Assembly Government is accountable to Parliament for the funds which are issued to the Welsh Assembly Government. The Principal Accounting Officer, and Sub-Accounting Officer of DCELLS, as Accounting Officer for the public funds to the sector, must be satisfied that proper arrangements are being operated in the financial management and other controls applied by the Welsh Assembly Government to safeguard public funds and ensure that they conform with the requirements of propriety and good financial management.

2.4 In order to obtain this assurance, the PAGS will periodically assess the internal management controls of providers. The PAGS will seek to achieve this in the most efficient way for example through reliance on the work of providers' own internal and external auditors.

### **Further Education Institutions**

2.5 The Governing Body of an institution is responsible for ensuring that funds from the Welsh Assembly Government are used only in accordance with the Act, the Financial Memorandum and any other conditions as prescribed by the Welsh Assembly Government from time to time. It is also responsible for ensuring that the financial and management controls established by the institution are sufficient to safeguard funds from the Welsh Assembly Government.

2.6 The Governing Body will require the Principal to take personal responsibility, as accounting officer, which may not be delegated, to assure them that there is compliance with the terms and conditions of the Financial Memorandum. The Principal may be required to appear before the Committee of Public Accounts or National Assembly Audit Committee on matters relating to grant paid to the institution.

2.7 Details of the Internal and External audit arrangements for institutions are set out in sections 4 and 5. The Governing Body must not appoint the same external provider to provide the institution with the internal and external audit service.

### **Irregularities including Fraud and Corruption**

2.8 An institution's management has responsibility for managing the risk of irregularity, including fraud and corruption. To discharge this responsibility, management must ensure that an adequate system of risk management, control and governance is established, this should include a comprehensive anti fraud policy and response plan, approved by the Audit Committee. The Principal must inform, without delay, the Welsh Assembly Government Sub-Accounting Officer, the Chair of the institution's Audit Committee and the Chair of the institution's Governing Body, of any serious weakness, significant fraud or major accounting breakdown.



2.9 The internal auditor should be informed of all suspected or detected fraud to enable the adequacy of the relevant controls and any impact on the opinion on risk management, control and governance to be considered. Internal Audit, in the planning and conduct of all its work should be alert to risks and exposures which might give rise to the possibility of irregularities. All irregularities must be reported immediately to the Principal, who must immediately (subject to the provisions of the Proceeds of Crime Act 2002) inform the PAGS of serious weaknesses, significant frauds or major accounting breakdowns.

2.10 In this Code, a serious weakness includes one that has resulted in an attempted, suspected or actual significant fraud or irregularity. Significant fraud is usually where one or more of the following applies:

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

There may be circumstances that do not fit this definition. In these cases institutions should seek advice or clarification from the PAGS.

2.11 The CIPFA publication 'A Handbook for Audit Committee Members in Further and Higher Education' provides further guidance on the role of audit in the Further Education Sector.

## Section 3

# Audit Committees in Further Education Institutions

3.1 The Governing Body of an institution must ensure that its responsibilities for proper financial management, for the effectiveness of the risk management, control and governance systems and for the economy, efficiency and effectiveness of the institution's activities, have been properly discharged. To ensure that its responsibilities are met, the Financial Memorandum requires the Governing Body to establish an Audit Committee. An effective Audit Committee, independent of executive management, with sufficient authority, can provide the Governing Body with impartial and authoritative advice on audit related matters.

3.2 The Audit Committee must be formally constituted to ensure that its relationship with the Governing Body, to whom it is accountable, is clear. It must be given written terms of reference, set for it by the Governing Body, which deal adequately with its membership, authority and duties. The duties of the Audit Committee will have to be determined in light of the institution's needs but should normally include those described in the model terms of reference provided at Annex B.

3.3 The Audit Committee must be properly constituted, appointed and given sufficient authority and resources by the Governing Body. The Governing Body should make funds available to the Audit Committee to take independent advice when the Audit Committee reasonably believes it is necessary to do so. It must have the right to obtain all the information it considers necessary and to consult directly with the internal and external auditors. The Committee must be advisory and must report directly to the Governing Body.

### **Membership of the Audit Committee**

3.4 The Audit Committee must consist of at least three members and the Committee should be able to co-opt members with particular expertise. A co-opted member of the Audit Committee must not be appointed as its Chair, since the Chair has to be able to attend, as of right, all meetings of the Governing Body. Subject to this, co-opted members must be treated as having the same status on the Audit Committee as full Governing Body members.

3.5 At least one member should have recent and relevant financial experience, but membership should not be drawn exclusively from people with such a background. The Chair of the Governing Body should not be a member of the Audit Committee. In order to ensure

independence and objectivity, members must not be members of the Finance Committee or its equivalent, or be a student governor. The Articles of Government for institutions permit employees of the corporation, excluding those in senior posts to be included in the membership. This is a matter for Governing Bodies to determine, however, they should have regard to any potential conflicts of interest that may exist. Where employees are appointed, a clear mechanism must be established for dealing with conflicts of interest as they arise. All members of the Audit Committee should act in the interests of the whole organisation rather than their specific business area.

3.6 The Governing Body should assess the training required to meet its own needs and those of its subcommittees and should establish a programme of training to meet those needs, including an induction programme for Audit Committee members.

3.7 Further advice on any aspect of Audit Committee membership is available from the PAGS.

### **Proceedings of the Audit Committee**

3.8 The Audit Committee should be given maximum discretion to determine its proceedings, within the terms of reference approved by the Governing Body. The Audit Committee must meet at least three times per academic year to ensure that sufficient time is available to cover all of the routine areas of business. The timing and content of the meetings should follow, as far as possible, the planning and reporting cycles of internal and external audit. The Audit Committee has the right, whenever it is satisfied that it is appropriate, to go into confidential session and exclude any or all participants and observers.

3.9 The internal auditor and the Director of Finance or representative should normally attend Audit Committee meetings. Other staff should also be invited to attend as appropriate, where their area of responsibility is under consideration. The external auditor should normally attend any meetings where business relevant to them is being considered. Both the internal and external auditor must have the right of direct access to the Chair of the Audit Committee and also the right to require the Chair to convene a meeting, if necessary.

3.10 The Clerk to the Governing Body should normally be the Clerk to the Audit Committee. In some circumstances it may be appropriate to appoint an alternative independent officer. Where

the Clerk has significant responsibilities at senior management level within the institution, the Governing Body should consider whether the independence of the Clerk's position is compromised and whether the role should be transferred to someone else or whether sufficient safeguards can be built into existing arrangements. If doubt exists as to the appropriateness of the Clerk having other responsibilities this should be queried with PAGS.

3.11 The Audit Committee must have explicit authority to investigate any matters within its terms of reference and full access to information and personnel.

3.12 The Audit Committee is responsible for establishing effective audit arrangements for the institution and these should include:

- a) advising the Governing Body on the scope of audit coverage;
- b) reviewing the institution's mechanisms for the assessment and management of risk;
- c) reviewing assurance mechanisms for ensuring compliance with the institution's corporate governance requirements;
- d) consideration of significant audit findings, conclusions and opinions;
- e) monitoring of responses to all audit recommendations, to ensure effective action is taken;
- f) monitoring the performance of the institution's auditors; and
- g) consideration and approval of the institution's strategy for value for money initiatives.

Further guidance on the duties of the Audit Committee is provided at Annex B.

3.13 Where the scope of internal audit coverage is restricted, or audit recommendations are not implemented, the Audit Committee should expressly consider the risks involved and how this affects the assurance to the Governing Body on the institution's risk management, control and governance processes.

3.14 The work of the Audit Committee should inform the Governing Body's assessment of the effectiveness of its systems of risk management, control and governance. This will have particular

relevance to the statement of Governors' responsibilities in the statutory accounts and to the Corporate Governance statement. The Audit Committee's annual report should therefore be considered by the Governing Body prior to the signature of the statutory accounts to ensure consistency.

3.15 The Audit Committee must produce an annual report to the Governing Body. This must provide the Audit Committee's opinion, drawing on the work of internal and external audit and any other work conducted during the year, on the extent to which the Governing Body, in discharging its responsibilities, may rely on the institution's risk management, control and governance processes. The report should also record the work of the Committee, including a review of:

- a) the external auditors' Management Letter and Communication with Those Charged with Governance;
- b) the internal auditors' annual report; and
- c) value for money exercises and any PAGS or other relevant work conducted during the year.

3.16 The report should highlight significant weaknesses identified and also any key issues for the institution arising out of its activity over the year. Further guidance on the content of the Audit Committee annual report is set out in Annex C. A copy of the annual report must be submitted, without delay, to the PAGS and include the internal audit annual report as an attachment. The Audit Committee's annual report should be submitted to the Governing Body before the members' responsibility statement and the Corporate Governance statement in the annual financial statements are signed.

3.17 The Audit Committee should establish appropriate performance measures for internal and external audit and monitor their performance annually. The review should form the basis of the recommendation to the Governing Body for the annual reappointment of the external auditors. Guidance on suitable performance measures is set out in Annex D.

3.18 The Audit Committee should review annually its terms of reference and its own effectiveness and recommend any necessary changes to the Governing Body.

## Section 4

# Internal Audit Arrangements in Further Education Institutions

4.1 Each institution must, in accordance with the Financial Memorandum with the Welsh Assembly Government, have an internal audit function. The prime responsibility of the internal audit function is to provide the Governing Body, Principal and line management with assurance on the adequacy and effectiveness of the institution's risk management, control and governance processes. Responsibility for the operation of these processes rests fully with line management.

4.2 An institution must ensure that it has sound systems of risk management, control and governance. These comprise the policies, procedures and operations in place to:

- a) establish and monitor the achievement of the institution's objectives;
- b) identify, assess and manage the risks to achieving the institution's objectives;
- c) advise on, formulate, and evaluate policy, within the responsibilities of the Principal and the Governing Body;
- d) ensure adherence to management's policies and directives and compliance with other relevant procedures, behavioural and ethical expectations, legislation and regulations;
- e) ensure the economical, efficient and effective use of resources;
- f) safeguard the institution'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 accounting records, other information and data including internal and external reporting and accountability processes.

### **Duties**

4.3 The internal audit of public bodies is different from audit in the commercial sector, since internal auditors must also be concerned with:

- a) the requirements of the Welsh Assembly Government; and
- b) the arrangements for securing economy, efficiency and effectiveness.

## **Role and Scope**

4.4 The scope of the internal audit service must embrace all of the risk management, control and governance processes of the institution covering all of its activities, including those not funded by the Welsh Assembly Government. However, audit strategies will be developed on a risk basis to cover those areas deemed as a priority for coverage, in agreement with the Audit Committee of the institution.

4.5 The primary responsibility of internal audit is to provide assurance to the institution's Principal and Governing Body on the adequacy and effectiveness of risk management, control and governance processes in operation at the institution.

4.6 As an integral part of its responsibility to evaluate the control system, internal audit will examine the controls established by management to secure value for money. In addition to this, the Audit Committee may consider it appropriate to use the services of the internal auditors to undertake specific value for money studies. The use of internal audit resources in this way should be included in the audit strategy and in the plans derived therefrom, to ensure that an adequate basis exists for the provision of assurance on the adequacy and effectiveness of governance, risk management and internal control processes.

4.7 When planning value for money studies care must be taken to ensure that the independence of internal audit is not compromised. Guidance on value for money arrangements is provided at Annex E.

4.8 Internal audit should be alert in all their work to risks and exposures that allow irregularity, fraud and corruption, although the primary responsibility for prevention and detection rests with management, who should establish adequate and effective systems of risk management, control and governance. The internal auditor should be informed of all suspected or detected fraud to enable the adequacy of the relevant controls and any impact on the opinion on risk management, control and governance to be considered.

## **Terms of Reference**

4.9 The internal audit service should have formal terms of reference agreed by the Governing Body, on the recommendation of the Audit

Committee. An illustrative model terms of reference is set out in Annex F. These terms of reference should form part of any contract or engagement letter for the provision of internal audit services.

4.10 The operation and conduct of the institution's internal audit service must be in accordance with GIAS. Where the internal auditor considers that compliance with the GIAS is not appropriate for any reason, the departure must be approved in advance by the Audit Committee and must be reported, in advance, to the PAGS.

## **Independence and Status**

4.11 Independence is fundamental to the effectiveness of internal audit. Accordingly, internal auditors must avoid any official, professional and personal relationships or interests which might cause them to limit the extent and character of their audit. Internal audit must determine its own priorities, within plans prepared after consultation with senior management and these must be approved by the Governing Body, on the recommendation of the Audit Committee. If internal audit is called upon to carry out specific investigations, such reviews must not compromise its objectivity, independence or achievement of the audit plan.

4.12 Internal audit must be a separate function from the management of the institution and must not have any management or executive responsibilities other than for internal audit. For day-to-day administrative purposes, the internal audit service will be responsible to a senior officer within the institution. In selecting this officer regard should be had to the potential for conflicts of interest and arrangements should be established to safeguard the auditor in this respect.

4.13 To be effective, internal audit should have sufficient status and be seen to have respect and support within the institution. The internal auditor must have direct access to the institution's Principal and to the Governing Body, normally through the Chair of the Audit Committee. The internal auditor must also have unrestricted access to all records, assets, personnel and premises, and be authorised to obtain such information and explanations as they consider necessary.



## Approach

4.14 Internal audit should adopt a risk based strategy. Internal auditors may, in addition to their core role of providing assurance, undertake work of an advisory nature to assist management to improve the risk management, control and governance processes. The provision of an opinion is not required in these situations.

4.15 The prime objective of the audit is to evaluate the effectiveness of the risk management, disclosing weaknesses and non-effectiveness, over control and poor value for money. To achieve this, the internal auditor should:

- a) identify and record objectives, risks and controls;
- b) establish the congruence of the objectives with higher level corporate objectives;
- c) evaluate management's risk analysis, taking account of their acceptance of specific risks;
- d) evaluate the controls in principle to decide whether or not they are appropriate and can be reasonably relied upon to achieve their purpose;
- e) identify any instances of over-control;
- f) evaluate the impact of any decision by management to accept risks rather than transfer or treat them;
- g) determine an appropriate strategy to test the effectiveness of risk management and controls;
- h) arrive at conclusions and report, making recommendations as necessary and providing an opinion on the effectiveness of risk management and control in the audited area;
- i) ascertain whether systems and controls are working to achieve the most economic, efficient and effective use of resources;
- j) draw attention to uneconomical or otherwise unsatisfactory performance arising from management's decisions, practices or policies; and
- k) liaise with external auditors and with the PAGS.

4.16 This approach enables the internal auditor to reach the conclusions necessary to form an opinion on the adequacy and effectiveness of the risk management, control and governance processes within the institution. The degree of control should be related to the risks involved and it is management's responsibility, under the oversight of the Governing Body, to exercise judgement in establishing the balance between risk and control.

### **Control and Risk Self Assessment (CRSA)**

4.17 CRSA involves the assessment of risks and controls by management within an organisation. It can represent a useful management tool, and can also provide a source of reference for the Corporate Governance statement. Because of their expertise in assessing control systems, internal auditors may be requested to advise on, or facilitate, this process. The PAGS does not discourage such involvement provided that it is provided for within the Audit Strategy and will not compromise its delivery. It is for institutions to determine whether or not to make use of CRSA but such work should supplement, not replace, internal audit work.

### **Planning**

4.18 The work of the internal auditor should be planned for each individual audit assignment and should be agreed with the institution before the audit commences.

4.19 Each internal audit cycle should start with a formal assessment of the institution's audit needs. This assessment must be used to develop an audit strategy which should include:

- a) identification of all areas for review using the institution's objectives and risk assessment as a primary resource.  
The strategy must include any risk which the internal auditor considers to be material to the institution's risk management control and governance, even if it is not included in managements risk priorities.;
- b) provision for systematic review of how effectively the institution's risks are managed by its policies, procedures and operations;
- c) establishment of the resources and skills required for the delivery of the audit strategy;

- d) identification of the audit techniques selected as most effective for delivery of the audit objectives; and
- e) provision for consideration, at least annually of the institution's risk management framework.

The internal and external auditors should liaise at the planning stage, to ensure that duplication of work is avoided and that it is clear where external audit intend to place reliance on the work of internal audit.

4.20 Internal audit should prepare periodic work plans designed to implement the audit strategy. The periodic plans should set out the assignments to be completed in the period, establishing broad resource and skills requirements and setting relative priorities for each assignment.

4.21 It is the responsibility of the Audit Committee, on the advice of the internal auditor, to make recommendations to the Governing Body regarding the level of audit coverage and corresponding expenditure on internal audit, having regard to the assessment of audit risk.

4.22 The audit strategy and periodic work plans must be approved by the Governing Body, on the recommendation of the Audit Committee. Any significant restriction of the level of audit coverage and the associated risk should be drawn to the attention of the Principal and the Governing Body and notified to PAGS.

## **Reporting**

4.23 Internal audit reporting arrangements should be determined by the Governing Body, on the advice of its Audit Committee and should safeguard the independence and objectivity of the internal auditor.

4.24 At the conclusion of each audit assignment, the internal auditor should provide a report to management. This sets out the findings and recommendations arising and, for all risk based audits, expresses an opinion on the adequacy and effectiveness of risk management, control and governance for the area examined.

4.25 The internal auditor must produce an annual report. The report should be for the institution's accounting period and should be submitted in time to inform the preparation of the Audit

Committee's annual report and the Governing Body's Corporate Governance statement. The report must be addressed to the Governing Body and Principal and be considered by the Audit Committee. As a minimum it must include the internal audit assessment of the adequacy, and effectiveness of the institution's risk management, control and governance processes. This opinion should be placed in its proper context - that is, the work undertaken has been based on the audit strategy and on the work carried out in the year, as well as incorporating the results of audits in previous years. If newly appointed, the Head of Internal Audit should take into account the work and opinions of the previous internal audit service. Further guidance on the content of the annual report is given in Annex H.

## **Standards**

4.26 The operation and conduct of the internal audit service must comply with GIAS (subject to the provisions of paragraph 4.10 of the Code) and guidance from relevant professional auditing and accountancy bodies and any additional guidance which may be issued by the Welsh Assembly Government from time to time.

## **Provision of Service**

4.27 There are a number of ways of procuring an internal audit service which would meet the requirements of the Financial Memorandum. These are as follows:

- a) appoint an 'in-house' team. This may also be supplemented, from time to time, with external consultants or contractors, under the direction of the internal auditor, to meet any peaks in workload or provide specialist skills; or
- b) contract with an external provider. Where an external provider is contracted to deliver internal audit services, this will preclude the provider from delivering external audit services. This requirement is necessary to enable the objective review of internal audit by external audit.

4.28 Institutions may choose to form a consortium with one or more other institutions as the basis for procuring internal audit services. Consortia may be organised on an 'in-house' basis, be contracted to an external provider or as a mixture of the two.

4.29 It is for each institution, advised by its Audit Committee, to establish which method is the most suitable and cost effective way of obtaining an internal audit service. Whatever method is adopted, institutions should consider market testing the internal audit services at least every five years. Guidance is provided in Annex J.

### **Quality Measurement**

4.30 The Audit Committee should implement measures whereby the effectiveness of the service can be monitored on an ongoing basis. In addition, in order to discharge their responsibility for assessing the performance of internal audit, the Audit Committee should review the effectiveness of internal audit and its compliance with relevant policies and standards. The Audit Committee should consider the performance measures used by internal audit. The external auditor should indicate the extent to which it has been able to rely on the work of the internal auditor and also draw the attention of the Principal and Audit Committee to any significant weaknesses in their operation noted during the course of their work. The Audit Committee should use this information to contribute towards their annual assessment of the performance of the internal audit service.

### **Change of Internal Audit Service**

4.31 Incoming auditors should take into account relevant audit documentation, work and opinions of the previous auditor in the preparation of the audit strategy, periodic audit plans and annual report. Institutions should also consider making arrangements for the incoming auditors to meet with the outgoing auditors. For institutions whose internal audit is provided on a contract basis, such arrangements should be included in the contract.

4.32 Where internal audit is provided on a contract basis, a fixed term of contract should be agreed and market testing at the expiry of the term should be considered. In the event of a change of auditors, institutions should ensure that there is no gap in provision.

4.33 Where possible, a change in internal auditors should be planned to coincide with the completion of a cycle of work and the submission of an annual report to the Audit Committee.

## **Removal or Resignation of Auditors**

4.34 The Governing Body (or other body responsible for the appointment of auditors) may by resolution remove the internal auditors before the end of their term of office in the event of serious shortcomings being identified.

4.35 Where the internal auditors cease to hold office for any reason, they should provide the Governing Body with a statement of any circumstances connected with their removal or resignation which they consider should be brought to the Governing Body's attention. The internal auditors may also requisition a special meeting of the Governing Body to consider the statement and make representations.

4.36 The Governing Body must inform the PAGS immediately of the removal or resignation of the internal auditors. In addition, the PAGS must be sent a copy of any statement provided to the Governing Body by the outgoing auditors.

## **Restriction of Auditors' Liability**

4.37 Where the internal audit service is provided through a contractual arrangement with an external provider, the provider may ask the institution to agree to a restriction in the auditors' liability arising from any default by the auditors. Governing bodies are not prohibited from accepting a restriction in liability, so long as they take into account the risks and potential consequences of any loss suffered as a result of negligence, the level of professional indemnity held and the wider interest of the institution's responsibility for public funds, as set out in the Financial Memorandum. The Governing Body, advised by the Audit Committee, must consider and approve such a request for a liability restriction.

## **Fraud and Irregularity**

4.38 Internal audit should be alert in all their work to risks and weaknesses in control that allow irregularity, fraud and corruption to occur. The primary responsibility for prevention and detection rests with management, who must establish adequate and effective systems of risk management, control and governance. The internal auditor should be informed of all suspected or detected fraud to enable the adequacy of the relevant controls and any impact on the opinion on risk management, control and governance to be considered.

## **Relationships with Other Auditors**

4.39 The internal auditors should liaise with the institution's external auditors and the PAGS to enhance the level of service provided to the institution. External audit should seek to place reliance on the work of Internal Audit where appropriate.

4.40 Copies of internal audit reports should be provided, as a matter of course, to the external auditors. The internal auditors should also receive copies of the external auditors' Management Letter and Communication with Those Charged with Governance and any other relevant reports produced by other agencies for the institution.

4.41 Where institutions are categorised by the Welsh Assembly Government as unsatisfactory (Category D) for financial health purposes, copies of internal audit reports, including action plans of how the institution will address the issues raised in that report, must be sent to the PAGS.

4.42 The PAGS must be allowed unrestricted access to the work of the internal and external auditors. This must be stipulated in the engagement letters of both the internal audit service and the external auditor.

## Section 5

# External Audit Arrangements in Further Education Institutions

### **Role of External Audit**

5.1 The external audit of public funds is different from audit in the commercial sector, since external auditors must also be concerned with:

- a) the requirements of the Welsh Assembly Government; and
- b) the arrangements for securing economy, efficiency and effectiveness.

5.2 The primary role of external audit is to report on the financial statements of institutions and to carry out such an examination of the financial statements and underlying records and control systems as is necessary to form an opinion on the statements. The report must state whether funding received from the Welsh Assembly Government (and other bodies and restricted funds where appropriate) has been properly applied for the purpose provided and in accordance with the Financial Memorandum. External auditors should have regard to the arrangements for securing economy, efficiency and effectiveness during the course of their work. However, no additional external audit work on the existence of arrangements to secure value for money is specifically required, although this may be undertaken at the request of a Governing Body.

5.3 Governing bodies may also request the external auditor to carry out work relating to the corporate governance statement. Where this is the case the external auditor's opinion should clearly state the scope of the work in this area.

### **Qualification of External Auditors**

5.4 Institutions must ensure that their auditors are eligible for appointment as external auditors and registered with the appropriate professional body. The Assembly Government has determined in devising this Code that the criteria for eligibility as external auditors of further education institutions should match those set in statute for higher education institutions (Schedule 7 of the Education Reform Act 1988). These are that the auditor must be:

- (a) an individual, or firm, eligible for appointment as a company auditor under section 25 of the Companies Act 1989;



- (b) a member of the Chartered Institute of Public Finance and Accountancy; or
- (c) a firm each of the members of which is a member of that institute.

## **Selection Criteria and Procedures**

5.5 Unless an institution's constitution prescribes otherwise, the Governing Body is responsible for appointing the external auditors. Selection criteria and procedures should be determined in advance of receiving proposals and should be endorsed by the Audit Committee. Further guidance on market testing is given in Annex J.

5.6 The respective duties of an institution and its external auditors should be presented clearly, in agreed terms of reference, in the letter of engagement.

## **Letter of Engagement**

5.7 The institution must send a copy of the letter of engagement and any subsequent changes to it, to the PAGS immediately on appointment, if the letter departs in any material way from ISA210 and the example paragraphs at Annex I.

## **Additional Services**

5.8 Whether or not the external auditors provide additional services, beyond the scope of the statutory audit, is generally a matter for the institution. However, any additional work must not impair the independence of the external auditor. An institution should agree precise requirements with the auditors and the Audit Committee should be invited to consider the extent and nature of the work to be undertaken. In order to provide a basis on which to judge the relationship between an institution and its external auditors, the institution must disclose separately, by way of a note to its financial statements, the fees paid to its external auditors for other services.

5.9 Where an external provider is contracted to provide the external audit service, this precludes that provider from also providing the internal audit service.

## **Reporting Arrangements**

5.10 As part of the audit of institutions' financial statements, the external auditors must report to the institution by way of a Management Letter and Communication with Those Charged with Governance, highlighting any significant matters arising from the audit. These documents, together with management responses, should be made available to the institution's Audit Committee in time to inform the drafting of the Committee's annual report. Institutions must send final copies of their external auditors' Management Letter and Communication with Those Charged with Governance and management responses to the PAGS by the last day of December of that year. The external auditors must report serious weaknesses, significant frauds or irregularities, or any major accounting breakdown to the Chair of the Governing Body, the Chair of the Audit Committee and the Principal.

5.11 The Principal of an institution must immediately report to the Welsh Assembly Government all serious weaknesses, significant frauds or irregularities, or any major accounting breakdowns which come to light. This process is necessary to assist the Director of Children, Education, Lifelong Learning and Skills in fulfilling his responsibilities as Sub-Accounting Officer.

## **Audit Report**

5.12 The external auditors will report in accordance with International Standards on Auditing and the guidance and example opinion set out in the latest annual Accounts Direction, including whether the financial statements present a true and fair view, funds for specific purposes have been properly applied and the degree of compliance with the Companies Act or other appropriate statutes.

5.13 External auditors will also be required to review the statement of corporate governance included within the annual financial statements and may be requested by the Governing Body to review the corporate governance statement. External auditors should make reference to this review in the financial statements in their audit opinion.

5.14 The Welsh Assembly Government's requirements for reports on certain statutory returns will be announced by circular.

## **Re-appointment of External Auditors**

5.15 Institutions should re-appoint the external auditors formally each year. The Audit Committee should assess the auditors' work each year, to ensure that the institution is receiving a service of sufficiently high standard and achieving value for money. The Committee should then make an appropriate recommendation to the Governing Body regarding the re-appointment of the auditor. Performance measures should be used as part of the assessment process. Provided that the service is satisfactory, it will not be necessary to repeat the full selection process each year, but market testing should be considered at least every five years and the length of the term of office of the assignment partner should not exceed seven continuous years.

## **Removal or Resignation of Auditors**

5.16 The Governing Body may, by resolution, remove the external auditors before the end of their term of office in the event of serious shortcomings being identified.

5.17 The external auditors who have resigned, or been removed from office for reasons not connected with any tendering process, will be entitled to attend, or make representations to, the meeting of the Governing Body at which their term of office would otherwise have expired, or at which it is proposed to fill the vacancy caused by their resignation or removal. They should receive notices of the meeting, and should be heard, on any part of the business which concerns them as former auditors of the institution, at that meeting.

5.18 Where the external auditors cease to hold office for any reason, they should provide the Governing Body with a statement of any circumstances connected with their removal, which they consider should be brought to the Governing Body's attention. The auditors may also requisition a special meeting of the Governing Body to consider the statement and make representations. These provisions are analogous to those of the Companies Acts.

5.19 The Governing Body must immediately inform the PAGS of the removal or resignation of the external auditors. In addition, the PAGS must be sent a copy of any statement provided to the Governing Body by the outgoing auditors.

5.20 In order to decide whether or not to accept the appointment, any firm proposing to take up office as external auditors should obtain the institution's permission to communicate with the outgoing auditors. Outgoing auditors should be granted permission by the institution to discuss its affairs freely with the proposed auditors and should disclose fully all information required by the proposed auditors which is relevant to the appointment. These provisions are in accordance with the ethical guidance published by the professional accountancy bodies.

### **Restriction of Auditors' Liability**

5.21 Section 310 of the Companies Act 1985 prohibits any capping of the auditors' liability in respect of audit opinions on financial statements given under the Act. Institutions must not agree to any such restriction in liability.

5.22 For other types of work performed by the external auditors, the provider may ask the institution to agree to a restriction in the auditors' liability arising from any default by the auditors. Institutions are not prohibited from negotiating a restriction in liability, so long as the outcome takes into account the risks and potential consequences of any loss suffered as a result of negligence, the level of professional indemnity held and the wider interest of the institution's responsibility for public funds as set out in the Financial Memorandum. The Governing Body, advised by the Audit Committee, must consider and approve any request for a liability restriction.

### **Welsh Assembly Government Access to External Auditors**

5.23 On occasion, the PAGS may wish to meet with institutions' external auditors. Access must not be limited in any way by the institution. Formal discussions with the external auditors will normally be arranged through the institution's Principal or representative. The PAGS will exchange letters where necessary with both parties which deal with confidentiality and the terms under which access is given.

## Section 6

# Audit Arrangements for the Welsh Assembly Government

### **Provider Audit and Governance Service**

6.1 Public funds are channelled through DCELLS and the Principal Accounting Officer of the Welsh Assembly Government is accountable to Parliament for the funds which are issued to the Welsh Assembly Government.

6.2 The Principal Accounting Officer, and Sub-Accounting Officer of DCELLS, as Accounting Officer for the public funds to the sector, must be satisfied that proper arrangements are being operated in the financial management and other controls applied by the Welsh Assembly Government to safeguard public funds and ensure that they conform with the requirements of propriety and good financial management. This function is discharged by the PAGS.

### **Role and Scope**

6.3 The PAGS is responsible for evaluating the risk management, control and governance processes of institutions funded by the Welsh Assembly Government and giving assurance to the Director of Children, Education, Lifelong Learning and Skills on those internal control arrangements.

6.4 The PAGS has no executive role nor does it have any responsibility for the development, implementation or operation of systems. It may, however, provide advice on risk, control and governance and related matters, subject to the need to maintain objectivity.

6.5 All institutions receiving funding from DCELLS fall within the scope of PAGS review. Rights of access to undertake examination of financial and management controls are provided for in the Financial Memorandum between the Welsh Assembly Government and each institution.

6.6 The PAGS also has a role in providing assurance on funds provided to Local Authorities to ensure that funds are used only in accordance with the Learning and Skills Act 2000 and any other prescribed conditions, and for Other Training Providers to ensure that they have appropriate arrangements for financial management and accounting and the uses to which Welsh Assembly Government funds are put are consistent with the purposes for which they are provided and comply with any conditions attached to them.

## **Responsibilities**

6.7 In order to provide the required assurance to the Director of Children, Education, Lifelong Learning and Skills, the PAGS will undertake a programme of work over a cycle to be agreed with the Sub-Accounting Officer with the following objectives:

- a) to ascertain the extent of compliance with established policies and procedures;
- b) to ascertain the extent to which assets and interests in funds provided to, or by, the Welsh Assembly Government, are properly controlled and safeguarded from losses of all kinds;
- c) to ascertain that accounting and other information is reliable as an underlying basis for the production of accounts and other returns;
- d) to identify and, where appropriate, test the controls established to ensure the integrity and reliability of information and data used by management; and
- e) to ascertain that systems of controls are laid down correctly and operate to achieve the most economic, efficient and effective use of resources.

## **Access**

6.8 The Head of the PAGS has a direct right of access to the Sub-Accounting Officer of DCELLS, as Accounting Officer for the public funds to the sector.

6.9 The PAGS has access to all records, information and assets of each institution and other Training Providers funded by the Department and can require any officer to give any explanation which it considers necessary to fulfil its responsibilities.

## **Approach**

6.10 For information, in carrying out its responsibilities the PAGS will:

### **For FE Institutions**

- a) assess whether all elements of the risk management, control and governance processes on which each institution intends

to rely have been identified, including those controls established by management to achieve the most economic, efficient and effective use of resources;

- b) ensure that audit needs have been assessed adequately through the audit strategy, review cycles have been established and that audit arrangements comply with the Code;
- c) evaluate institutions' risk management, control and governance processes with a view to placing reliance on them and recommend, where appropriate improvements; and
- d) undertake a cycle of visits to each institution to gain an overview of the key management controls in operation across a range of activities including governance, strategic, administrative and financial management as well as its audit arrangements. This overview will make use of any work carried out by the institution's internal and external auditors.

### **For Local Authorities**

- a) as set out in the Local Authority Audit Guidance for ELWA Funding issued in March 2006, undertake a cycle of peer reviews to determine the level of reliance which may be placed upon the work of the Local Authority Internal Auditor's:
  - 1) reviews of the systems and controls over data submitted to the Welsh Assembly Government including data submitted to the LA by individual schools;
  - 2) reviews of the internal control environment in operation within individual schools;
  - 3) reviews of the systems and controls over student enrolments and attendance and data submitted to the Welsh Assembly Government by the Providers of Community Learning where the LEA is in receipt of a material amount of funding in this area.

### **For Other Training Providers**

- a) as set out in the Audit of Work Based Learning Funding Data Guidance for Welsh Assembly Government funding which is issued on an annual basis, undertake a cycle of peer reviews of appointed external auditors of providers with an annual contract value in excess of £1m to gain assurance on the

quality and consistency of work being undertaken and the adequacy of reporting of findings and an overview of the level of reliance which may be placed upon their work;

- b) undertake a cycle of visits to providers with an annual contract value less than £1m which will be based on the following core audit processes:
  - 1) identification and evaluation of the overall approach adopted by the provider to the management and control of the WBL contract;
  - 2) identification, evaluation and where appropriate compliance testing of the system of internal control relating to the claim for and use of Welsh Assembly Government funds; and
  - 3) substantive testing of the provider's LLWR data to establish the extent of compliance with the payment conditions of the Welsh Assembly Government WBL contract.

## Reporting

6.11 For day to day administrative purposes only, the Head of the PAGS reports to the Head of Standards, Quality and Governance on the performance of the PAGS. The Head of the PAGS will, where appropriate, draw the attention of the Director of Children, Education, Lifelong Learning and Skills to significant findings or recommendations.

6.12 The PAGS will produce a report on the completion of each audit. The report will give an opinion on the area reviewed and make recommendations where appropriate. Reports on the results of audit examinations will be discussed with auditees and the facts agreed. Each report will include an agreed action plan for improvement and material recommendations will be followed up by the PAGS. All final versions of audit reports will be made to the Director of Children, Education, Lifelong Learning and Skills.

6.13 Institutions must complete all agreed actions and will be required to inform the PAGS of progress. Follow up visits will also be conducted by the PAGS, to review progress.



6.14 The Head of the PAGS will directly submit an annual report to the Director of Children, Education, Lifelong Learning and Skills. This report will include an assessment of the adequacy and effectiveness of the sector's risk management, control and governance processes and report achieved coverage against that planned.

### **Standards**

6.15 The operation and conduct of the PAGS should conform to GIAS. The PAGS should also have regard to relevant guidance provided by professional auditing and accountancy bodies.

### **Liaison**

6.16 The PAGS will liaise, where appropriate, with the Wales Audit Office, the Welsh Assembly Government internal audit service, institutions' internal and external auditors, the Learning and Skills Council (LSC), the Scottish Funding Council (SFC) and any other relevant organisation.

### **Value for Money**

6.17 The PAGS will undertake value for money studies across the Further Education Sector and, where appropriate, in conjunction with the LSC and the SFC to ensure that systems of control are laid down and operate to achieve the most effective, efficient and economical use of resources.

## Annex A

# Mandatory Requirements for FE Institutions

The following requirements within this Code are mandatory and represent conditions of funding under the Financial Memorandum with the Welsh Assembly Government:

1. Institutions must keep proper accounts and accounting records and provide, in respect of each financial year, financial statements prepared in accordance with approved Sector Accounting Policies and any relevant legislation.
2. Each institution must have an effective internal audit function, which must produce an annual report to the Governing Body and Principal.
3. Each institution must have an effective external audit function, which must produce a Management Letter and Communication with Those Charged with Governance to the Governing Body.
4. Each institution must have an effective Audit Committee, which must meet at least three times per year and produce an annual report to the Governing Body.
5. Each institution must have sound risk management, control and governance processes.
6. The internal audit service must cover the whole process of risk management, control and governance of the institution.
7. The Audit Committee of each institution, advised by its internal audit service, must satisfy itself that satisfactory procedures are in place to audit the arrangements to secure economy, efficiency and effectiveness.
8. The internal auditor must have direct access to the institution's Principal, the Chair of the Audit Committee and, if necessary, the Chair of the Governing Body. Internal auditors must also have unrestricted access to all records, assets, personnel and premises and be authorised to obtain whatever information and explanations the head of the internal audit service considers necessary.
9. DCELLS' Audit Service, PAGS, must have access to all records, information and assets and be able to require any officer to give any explanation which it considers necessary to fulfil its responsibilities. This includes access to any work of, and correspondence between, the internal and external auditors.

10. A copy of the Audit Committee's annual report, with the internal auditors' annual report and a copy of the external auditors' Management Letter and Communication with Those Charged with Governance, together with the institution's response, must be provided by institutions, to the PAGS, by the last day of December of that year.
11. The Principal must report without delay, to the Welsh Assembly Government Sub-Accounting Officer, the Chair of the Audit Committee and the Chair of the Governing Body serious weaknesses, significant frauds or major accounting breakdowns.
12. The Governing Body must inform the PAGS, without delay, of the removal or resignation of the internal or external auditors and provide a copy of any letter of representation that they have made.
13. No member of the Audit Committee may also be a member of the Finance Committee or its equivalent or be a student governor.
14. The Governing Body must not accept any restriction of liability in respect of the external audit of the institution's financial statements.
15. Where institutions are categorised by the Welsh Assembly Government as unsatisfactory (Category D) for financial health purposes, copies of internal audit reports must be sent to the PAGS by the institution.
16. The operation and conduct of the institution's internal audit service must be in accordance with GIAS. Where the internal auditor considers that compliance with GIAS is not appropriate for any reason, the departure must be approved in advance by the Audit Committee and must be reported in advance to the PAGS.
17. The Governing Body must not appoint the same accountancy firm to provide the institution both with the internal and external audit service.

## Annex B

# Model Terms of Reference for an Audit Committee

1. These terms of reference are provided for guidance. It is for the Governing Body of an institution to determine the terms of reference of the Audit Committee. In so doing it should have regard to this Code of Practice and, in particular, should comply with the mandatory items contained in Annex A.

### **Constitution and Membership**

2. The Governing Body will establish a Committee of the Governing Body to be known as the Audit Committee.

3. The Committee and its Chair will be appointed by the Governing Body and will consist of members with no executive responsibility for the management of the institution. There shall be not less than three members. A quorum shall be at least two members. The Chair of the Governing Body will not be a member of the Committee. The Chair of the Committee will be a member of the Governing Body. At least one member should have recent and relevant financial experience, but membership should not be drawn exclusively from people with such a background. The Committee may co-opt members with particular expertise. No member of the Committee may also be a member of the Finance Committee or its equivalent or a student at the institution (including student governors). The Principal must not be a member, but may be invited to attend meetings where the Committee deems that this is appropriate.

### **Authority**

4. The Committee is authorised by the Governing Body to investigate any activity within its terms of reference. It is authorised to seek any information it requires from any employee and all employees are directed to co-operate with any request made by the Committee.

5. The Committee is authorised by the Governing Body to obtain independent professional advice and to secure the attendance of non-members with relevant experience and expertise if it considers this necessary.

### **Proceedings**

6. The Committee must meet at least three times per academic year to ensure that sufficient time is available to cover all of the routine areas of business. The external or internal auditors may require

a meeting if they consider it necessary. The Director of Finance (or equivalent) and the internal auditors should normally attend Audit Committee meetings, together with other staff invited to attend where appropriate. The external auditors should normally attend any meetings where business relevant to them is being discussed. However, at least once a year the Committee should meet with the institution's auditors without any officers present.

## **Duties**

7. The duties of the Committee include:

- a) ensuring the institution complies with the mandatory requirements of the Code;
- b) reviewing the institution's mechanisms for the assessment and management of risk;
- c) reviewing the assurance mechanisms for ensuring compliance with the institution's corporate governance requirements;
- d) advising the Governing Body on the appointment and terms of engagement of the internal auditors, the audit fee, the provision of non-audit services by the internal auditors and any question of resignation or dismissal of the internal auditors;
- e) advising the Governing Body on whether the institution has adequate systems and procedures in place to promote economy, efficiency and effectiveness;
- f) advising the Governing Body on the appointment and remuneration of the external auditors and the scope of their work, including any non-audit services provided and any question of resignation or dismissal, monitoring the rotation of the assignment partner in compliance with applicable United Kingdom ethical guidance, and making a recommendation on annual reappointment of the external auditors to the Governing Body;
- g) agreeing the nature and scope of audit work;
- h) discussing findings and conclusions arising from audits, including a review of the external auditor's Management Letter and Communication with Those Charged with Governance incorporating management responses;

- i) considering the institution's draft annual financial statements, after review by the Finance Committee and prior to submission to the Governing Body for formal approval. This review should include specific consideration of significant accounting policies and any changes in those policies, members' responsibilities and any corporate governance statement. The Committee's view on any statement of the effectiveness of the internal control system will be provided to the Governing Body as part of the Committee's annual report;
- j) reviewing the effectiveness of internal control systems and, in particular, to review the external auditors' Management Letter and Communication with Those Charged with Governance, the internal auditors' annual report and management responses;
- k) reviewing and recommending to the Governing Body the internal auditor's audit strategy and the audit plan, including any changes made during the year;
- l) considering major findings of internal audit investigations and management's response;
- m) promoting co-ordination between internal and external auditors;
- n) ensuring that the resources made available for internal audit are sufficient to meet the institution's needs;
- o) monitoring the implementation of agreed audit recommendations;
- p) reviewing relevant reports from the PAGS, WAO and other organisations and monitoring the implementation of relevant recommendations;
- q) monitoring the performance and effectiveness of external and internal audit as the basis for recommendations to the Governing Body concerning their reappointment;
- r) overseeing the institution's policy on fraud and irregularity, including any action taken under that policy;
- s) reviewing the institution's whistleblowing arrangements, i.e. the process by which staff or Governors of the institution may, in confidence, formally raise concerns;
- t) ensuring that all significant losses have been properly investigated and that the internal and external auditors and the PAGS have been fully informed of the matter; and

- u) monitoring the implementation of audit related letters and guidance.

### **Reporting Procedures**

8. The Committee will circulate the minutes of its meetings to the Governing Body and there should be an opportunity at meetings of the Governing Body to discuss matters raised by the minutes.

9. The Committee will produce an annual report which it will submit to the Governing Body, accompanied by the internal auditors' annual report, summarising the activity for the year. It will give the Committee's opinion, based on the work of internal and external audit and any other work conducted during the year, on the effectiveness of the internal control system, including risk management and governance arrangements. The report should be submitted in time to be taken into account by the Governing Body in its consideration of the members' responsibility statement in the annual financial statements. Guidance on the content of the annual report is provided in Annex C.

### **Clerking Arrangements**

10. The Clerk to the Governing Body (or other appropriate independent individual) should be the Clerk to the Audit Committee.

## Annex C

# Guidance on the content of an Audit Committee Annual Report

1. This Code of Practice requires each Audit Committee to produce an annual report to the Governing Body (paragraph 3.15) summarising the Audit Committee's opinion on the effectiveness of the institution's audit arrangements and its opinion on the extent to which the Governing Body can rely on the risk management, control and governance arrangements of the Institution. These opinions are drawn from the work of internal and external audit and any other work conducted during the year. This annex provides guidance on what could be included in the report.

### **Introduction**

2. The period covered, which should specifically relate to the Audit Committee's work on the relevant financial year. However, any additional issues should be covered where appropriate, particularly if they affect the opinion.

### **Membership**

3. Details of the names and terms of office of Audit Committee members, details of membership changes and dates thereof. Identification of the Chair, and details of the clerk to the committee.

### **Meetings**

4. Dates of meetings and summary of members' attendance.

### **Terms of reference**

5. If applicable, details of changes to the Audit Committee's terms of reference and their effect on the work of the committee.

### **Internal audit**

6. Name of internal audit provider and details of any changes made or due as a result of market testing.

7. Review of the internal audit annual report (which should be attached to the audit committee annual report) including the degree of completion of planned work and consideration of and comment on the internal auditors' overall opinion on risk management, control and governance arrangements.



8. Review of the audit risk assessment and strategy as appropriate, including the number of audit days provided and details of any restrictions placed on the work of the internal auditors.

9. Review of the significant findings from audit reports and the Audit Committee's view of management responses to the findings and recommendations, and details of any significant recommendations outstanding.

### **External audit**

10. Name of external audit provider and details of any changes made or due as a result of market testing. Audit Committee's confirmation to governing body of recommendation of annual re-appointment.

11. Review of the external auditors' Management Letter and Communication with Those Charged with Governance report (ISA 260), including significant points arising and the Audit Committee's view of management responses to the findings and recommendations.

### **Other work done**

12. Review of the risk management strategy of the institution.

13. Other work done, which may include:

- A review of Audit Related Letters and management's responses;
- Value For Money studies and reports;
- special reports or investigations arising not dealt with elsewhere (for example on fraud or irregularity);
- review of Financial Regulations including amendments; and
- Issues not relevant to the reporting year, such as forthcoming events and issues relating to prior years.

### **Opinion**

14. The audit committee's opinion on the effectiveness of the institution's audit arrangements and its opinion on the extent to which the Governing Body can rely on the risk management, control and governance arrangements of the Institution.

## Annex D

### Guidance on performance indicators for Internal and External Audit

1. Paragraph 3.17 of this Code of Practice requires each Audit Committee to establish appropriate performance measures for internal and external audit and monitor their performance annually. The review is to form the basis of the recommendation to the Governing Body for the annual reappointment of the external auditors. This annex provides guidance on performance indicators that could be included in the list adopted.

2. An ideal set of performance measures is difficult to devise. In many cases, the most successful indicators necessarily contain a large degree of subjective opinion. Table 1 contains suggested performance measures for the internal audit service. This list is not exhaustive nor necessarily appropriate to all institutions. An appropriate set of performance measures may consist of a selection from those listed below. Each measure is given a suggested frequency of monitoring.

**Table 1: Suggested Performance Measures for Internal Audit**

| Indicator   | Timing                      |
|---|-----------------------------|
| <b>Cost of Service</b>  |                             |
| cost of service year-on-year  | annual                      |
| external comparisons with other institutions  | as possible                 |
| <b>Planning</b>   |                             |
| submission of plans to the Audit Committee in time for agreement by the Governing Body at the start of year to which they relate, and in any event, before the commencement of work | annual, at time of planning |
| <b>Audit Coverage</b>   |                             |
| actual days input compared to the annual plan   | annual                      |
| completion of every audit assignment in the annual plan, subject to variations agreed by the Audit Committee  | annual                      |
| <b>Audit Reports</b>  |                             |
| fulfilment of the scope and objectives of each assignment in the annual plan  | after each assignment       |

| <b>Indicator</b>   | <b>Timing</b>                |
|--|------------------------------|
| evaluation of all systems objectives and control objectives identified for each system reviewed.   | after each assignment        |
| conformity with the Audit Code of Practice requirements, especially on the internal auditor's annual assurance given to the Governing Body and Principal | annual                       |
| issue of draft and final reports within the period specified in the internal audit service's terms of reference  | after each assignment        |
| performance of follow-up work within an agreed timescale following finalisation of reports   | annual                       |
| <b>Relationships</b>   |                              |
| evidence of co-ordination between the internal audit service and the external auditor  | annual                       |
| attendance at audit committee  | each audit committee meeting |
| senior management's opinion of the internal audit service  | annual                       |
| <b>Other</b>   |                              |
| results of review of the work of the internal audit service by the external auditor if they intend to rely on it   | annual                       |
| results of review of the work of the internal audit service by the PAGS  | as appropriate               |

3. Table 2 contains suggested performance measures for external audit services. As above this list is not exhaustive nor necessarily appropriate to all institutions and an appropriate set of performance measures may consist of a selection from those listed below.

**Table 2: Suggested Performance Measures for External Audit**

| <b>Indicator</b>   | <b>Timing</b> |
|--|---------------|
| <b>Cost of Service</b>   |               |
| cost of service  | Annual        |
| external comparisons with other institutions   | as possible   |
| <b>Quality of Audit</b>  |               |
| the adequacy of the work done to produce the Management Letter and Communication with Those Charged with Governance letter               | Annual        |
| the depth, impact and usefulness of recommendations in the Management Letter and Communication with Those Charged with Governance letter | Annual        |
| the degree of acceptance of recommendations and their actual implementation (this may also indicate a poor response from management)     | Annual        |
| whether any subsequent material errors within the financial statements were detected   | Annual        |
| the make-up, skills and stability of the external audit team against expectations  | Annual        |
| <b>Timeliness of Audit</b>   |               |
| completion of audit work in accordance with timetable  | annual        |
| <b>Relationships</b>   |               |
| evidence of co-ordination between the internal audit service and the external auditor  | annual        |

| Indicator   | Timing                                  |
|---|---|
| attendance at Audit Committee                                     | each audit committee meeting invited to |
| senior management's opinion of the external auditor               | annual                                  |
| <b>Other</b>  |   |
| results of review of the work of the external auditor by the PAGS | as appropriate                          |

# Annex E

## Guidance on value for money arrangements

### Introduction

1. In the Further Education sector there is an underlying duty of care to ensure that public funds are spent on the purposes for which they are intended, and that good value for money (VFM) is sought. This duty is included as a condition of grant in the financial memorandum between each Further Education Institution and the Welsh Assembly Government, which states that the Governing Body of the institution is responsible for delivering value for money from public funds and it should keep under review its arrangements for managing all the resources under its control.

2. Paragraph 3.12 requires the Audit Committee to oversee the Institution's arrangements for securing VFM. In addition to the Audit Committee, committees dealing with finance, resources and property are likely to most obviously encounter VFM considerations. However, all committees of the Governing Body should have regard to VFM and should draw any significant VFM related issues to the attention of the Audit Committee or the governing body.

3. Executive responsibility for VFM resides with the head of institution, with the responsibility ideally cascading down through senior management to all levels of the organisation.

### VFM arrangements

4. VFM arrangements should address three elements, commonly referred to as the 'three Es' - economy, efficiency and effectiveness, which are:

- economy - obtaining resources at best value, taking both price and quality into account
- efficiency - how well resources are converted into outputs
- effectiveness - application of outputs to achieve the organisation's objectives

5. There is no single ideal approach to seeking VFM, but Further Education Institutions should be able to demonstrate that suitable arrangements are in place. These arrangements could be described in a VFM strategy document, which should set out a cycle of VFM reviews, incorporate specific actions, targets and dates. This strategy will help to ensure co-ordination of effort across the institution and sharing of good practice and help to avoid gaps and overlaps.

6. Those responsible for procurement continuously address VFM issues, and a procurement strategy and annual procurement report will help to demonstrate the institution's approach to VFM.

7. VFM work may also be carried out by external consultants providing the additional resource or expertise required, e.g. specialist energy consultants.

8. VFM considerations should be an integral part of the routine work of the internal auditors. It is good practice for internal auditors to give an opinion in relation to each assignment carried out, and this can include an opinion on VFM aspects and an indication of areas which might benefit from VFM review. Internal auditors may also be asked to carry out specific VFM studies, which can be particularly effective due to their objectivity and professional expertise in review, analysis and investigative work.

9. The internal audit service's terms of reference should separately identify any responsibility it may have in initiating, conducting or participating in VFM studies. The emphasis of such work should be to help management meet its responsibility for securing the economic, efficient and effective use of resources.

### **VFM reporting**

10. The following forms of reporting are useful elements in drawing together the Audit Committee's overall view on VFM arrangements:

- The opinions or conclusions on VFM issues included in internal audit assignment reports and in the internal audit annual report;
- The annual procurement report; and
- Any reports on VFM studies, internal VFM reviews and other forms of management review.

11. An effective way of demonstrating how VFM considerations are addressed by the Institution is for an annual report to be made to the Audit Committee on VFM arrangements and achievements, including reference to ongoing or routine activities which contribute to good VFM as well as specific VFM projects.

# Annex F

## Illustrative Model Terms of Reference for an Internal Audit Service

### **Role**

1. The role of internal audit is to provide management with independent assurance on the adequacy and effectiveness of the risk management, governance and control processes. In itself, internal audit represents a key part of an institution's internal control system, because it provides assurance on the adequacy, effectiveness and reliability of other controls in order that:

- a) the Governing Body and senior management can assess the extent to which they may rely on the whole control system; and
- b) individual managers can assess how reliable the systems and controls are, for which they are responsible.

2. It remains the duty of management, under the oversight of the Governing Body, not the internal auditors, to establish the system of internal controls. It is for management to determine whether to accept and implement recommendations made by the internal auditors, or alternatively, to recognise and accept the risks resulting from not taking action.

### **Scope**

3. The work of the internal auditors must embrace the whole internal control system of the institution, including all its activities, funded from whatever source. The internal audit service will consider the adequacy and effectiveness of the risk management, governance and control processes in all areas. It will seek to confirm that management have taken the necessary steps to achieve these objectives. Academic audit is specifically excluded from this process.

4. It is not within the remit of the internal auditors to question the appropriateness of policy decisions. However, the internal auditors are required to examine the management arrangements of the institution by which such decisions are made, monitored and reviewed. The internal audit service may also conduct any special reviews requested by the Governing Body, Audit Committee or Principal, provided such reviews do not compromise their objectivity, independence or the achievement of their plan to audit the internal control system.



## **Planning**

5. The work of the internal auditors should be fully planned. Plans should be prepared, which detail the work to be undertaken. These plans should be approved by the Governing Body, on the advice of the Audit Committee.

## **Responsibilities**

6. The internal auditors are required to give an annual opinion to the Governing Body, through the Audit Committee, on the adequacy and effectiveness of the risk management, governance and control processes.

## **Standards and Approach**

7. The internal auditors' work will be performed with due professional care, in accordance with the requirements of the Code and should comply with the Auditing Guideline 'Guidance for Internal Auditors'. Internal auditors must also comply with GIAS. (subject to the provisions of paragraph 4.10 of the Code).

8. In achieving their objectives, the internal auditors should:

- a) identify and record objectives, risks and controls;
- b) establish the congruence of the objectives with higher level corporate objectives;
- c) evaluate management's risk analysis, taking account of their acceptance of specific risks;
- d) evaluate the controls in principle to decide whether or not they are appropriate and can be reasonably relied upon to achieve their purpose;
- e) identify any instances of over-control;
- f) evaluate the impact of any decision by management to accept risks rather than transfer or treat them;
- g) determine an appropriate strategy to test the effectiveness of risk management and controls;
- h) arrive at conclusions and report, making recommendations as necessary and providing an opinion on the effectiveness of risk management and control in the audited area;

- i) ascertain whether systems and controls are working to achieve the most economic, efficient and effective use of resources;
- j) draw attention to uneconomical or otherwise unsatisfactory performance arising from management's decisions, practices or policies; and
- k) liaise with external auditors and with the PAGS.

The internal auditor should agree performance indicators with the Audit Committee and should periodically report actual performance against these.

## **Independence**

9. The internal auditors will have no executive role, nor any responsibility for the development, implementation or operation of systems. The internal auditors may provide advice on control and related matters, subject to the need to maintain objectivity and subject to resource constraints.

10. The Audit Committee will advise the Governing Body on all matters concerning internal control. Within the institution responsibility for internal control rests fully with management, as does responsibility for implementing audit recommendations.

## **Access**

11. The internal auditors have right of access to all of the institution's documents, records, information and assets, which they consider necessary to fulfil their responsibilities.

12. The internal auditors have a direct right of access to the Chair of the Audit Committee, the Chair of Governors and the Principal.

## **Reporting**

13. The internal auditors should submit, in advance of the year, an audit plan derived from an audit strategy to the Audit Committee, for consideration and agreement. This should then be forwarded to the Governing Body for approval.

14. The internal auditors are accountable to the Principal and the Governing Body, through the Audit Committee, for the performance

of the service. They should also report audit results to appropriate line management. The internal auditors will keep the Principal informed of audit results and draw the attention of the Audit Committee to significant findings or recommendations.

15. The internal auditors will report in writing, usually within one month of completion of each audit, giving an opinion on the adequacy, effectiveness and reliability of the control framework for the area reviewed and making recommendations where appropriate. Reports should be copied to the Principal and to the Audit Committee. Appropriate managers will be required to respond to each audit report, usually within one month of issue, stating their agreed action in response to the recommendations and the dates by which such action will be implemented.

16. The internal auditors should follow up significant recommendations within six to twelve months to confirm the status of agreed action. Significant recommendations should be reported to the Audit Committee and in the internal auditors' annual report, where the agreed action has not been taken. In addition the Audit Committee must monitor the implementation of audit recommendations by management.

17. The internal auditors should also submit an annual report to the Governing Body and Principal, giving an opinion on the adequacy and effectiveness of the risk management, control and governance processes within the institution.

18. The internal auditor's annual assurance to the Governing Body and the Principal will cover:

- a) the internal auditor's opinion on the adequacy and effectiveness of the risk management, control and governance processes within the institution and the extent to which the Governing Body can rely on it. In providing this assurance the scope of the work performed, any limitations placed on internal audit and any other factors affecting the quality of the assurance given should be clearly indicated;
- b) details of the achieved coverage against audit plans and explanations of significant variations;
- c) details of the extent to which the audit needs of the institution have been met;

- d) any significant audit recommendations, which the internal auditors consider have not received adequate management attention; and
- e) a statement confirming that the periodic audit plan has been reviewed, and concluding that either no changes are necessary or, if changes are proposed, a revised periodic audit plan should be provided and reasons for the proposed changes explained.

### **Irregularities including Fraud and Corruption**

19. The internal auditors must report any serious weaknesses, significant fraud or major accounting breakdown identified during the course of their work to the Principal and the Audit Committee.

20. Management may wish to consider utilising the knowledge and experience the internal auditors have of the Institution's systems to conduct an independent investigation into an actual or suspected fraud or irregularity (subject to the provisions of the Proceeds of Crime Act 2002). Such work should not compromise planned audit work.

### **Liaison**

21. The PAGS must be allowed unrestricted access to the work of the internal auditors. This must be stipulated in the engagement letter.

22. The internal auditors should liaise with the institution's external auditors and the PAGS to enhance the level of service provided to the institution.

## Annex G

# Guidance on audit areas that may be included in an Internal Audit Strategy

1. As part of its role of providing independent assurance on the adequacy and effectiveness of the risk management, governance and control processes within an Institution, internal audit are required by GIAS to undertake an audit needs assessment to determine the relative risk and hence frequency with which each system should be audited. The audit strategy for the institution is derived from the outcomes of this assessment.

2. A list of possible activities and systems is provided below, which was included as part of the Audit Needs Assessment Guidance issued in December 1999. This list represents areas likely to be common to most Further Education institutions. It should be seen as a useful checklist for use by internal auditors and Audit Committees.

3. The list should not be treated as a definitive list of systems within Further Education institutions since each institution will differ and is likely to include other systems, some of which may be high risk. It is also unrealistic to expect Internal Audit to cover each system annually; the audit strategy should set out a programme of coverage over the life-cycle of the strategy.

### **System/Activity**

#### **Financial Systems**

Payroll  
Nominal Ledger  
Creditors  
Procurement  
Debtors  
Income  
Cash & Bank  
Treasury Management  
Budgetary Control  
Travel & Subsistence  
Petty Cash  
Financial Regulations  
VAT & Tax  
Assets & Inventories  
Insurance

## **Other Systems**

Corporate Governance  
Risk Management  
Human Resources Management  
Staff Pre-appointment Checks  
Restructuring/Redundancy  
Estates Management  
Capital Projects  
Contract management  
Employment of Consultants  
Student Records  
Catering  
Residences  
Computer Systems  
European Grants  
Strategic Planning  
Health & Safety  
Collaborative Provision  
Subsidiary Companies  
Students' Union  
Security  
Stocks & Stores  
Research Projects  
Academic Departments  
Follow Up

## Annex H

# Guidance on the content of an Internal Audit Annual Report

### **Introduction**

1. Paragraph 4.25 of this Code and GIAS require the internal auditor to produce an annual report to the Governing Body and Principal giving an opinion on the adequacy and effectiveness of the risk management, control and governance processes within the institution. The annual report should include the following areas.

### **Internal Audit Planned Coverage and Output**

2. This opinion should be placed in its proper context - that is the work undertaken has been based on the audit strategy and on the work carried out in the year, as well as incorporating knowledge of audits in previous years (including from a previous auditor).

3. The level of internal audit input (days) agreed to by the Governing Body for the year.

4. Details of

- the approved plan of reviews;
- the type of review (systems audit, compliance audit, controls self-assessment, etc.);
- the planned number of days for each review; and
- the actual time against plan.

### **Management Action on Recommendations**

5. Details of any significant audit recommendations, which internal audit considers have not received adequate management attention.

### **Overall Assurance**

6. Details of the factors taken into account in providing reasonable assurance to the Governing Body that there are no major weaknesses in the college's risk management, control and governance processes. These will include:

- all audits undertaken during the year reported upon

- any follow-up action taken in respect of audits from previous periods
- any significant recommendations not accepted by management and the consequent risks
- the effects of any significant changes in the college's objectives or systems
- matters arising from previous reports to the Governing Body
- any limitations which may have been placed on the scope of internal audit
- the extent to which resource constraints may impinge on the head of the Internal Audit Service's ability to meet the full audit needs of the college
- what proportion of the college's audit need has been covered to date

## **Opinion**

7. The Head of Internal Audit's overall conclusion as to the adequacy and effectiveness of the college's risk management, control and governance processes to manage the achievement of the college's objectives.

8. The opinion expressed in the annual Internal Audit on the organisation's internal control system will form an important source of assurance for the corporate governance statement, and should highlight any issues which the internal auditor considers to be particularly relevant to the preparation of the corporate governance statement.

## **Performance of the Internal Audit Service**

9. The annual report should provide a set of internal audit performance measures (agreed with the Audit Committee), compare these with the actual performance, and provide explanatory comments as appropriate.



10. The report should include a statement confirming that the audit needs assessment has been reviewed, and concluding that either no changes are necessary or, if changes are proposed, that a revised audit needs assessment will be provided and reasons for the proposed changes.

11. Confirmation that Internal Audit have complied with the Government Internal Audit Standards (GIAS) and the requirements of the WAG Audit Code of Practice.

# Annex I

## Terms of Engagement for External Auditors

**The external auditors should provide an institution with a letter of engagement for each year of appointment. The letter should comply with the provisions of ISA 210 and should cover the areas set out in the example paragraphs below. The institution is required to notify the PAGS of any significant departure from ISA 210 or the paragraphs below.**

### **Appointment and Qualification**

1. We understand that the Governing Body will consider annually the re-appointment of the auditors and that a competitive selection process may be held at least every five years. Remuneration will be fixed by the Governing Body on the advice of the Audit Committee.

2. We confirm that we are eligible for appointment as auditors in accordance with the Companies Act 1989 and as set out in Schedule 7 of the Education Reform Act 1988.

### **Responsibilities of the Institution**

3. We recognise that the Governing Body is responsible, on behalf of the institution, for:

- a) establishing and maintaining a system of controls, financial and otherwise, in order to carry on the operation of the institution in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets, ensure that funds have been applied for the purposes for which they were given and secure, as far as possible, the completeness and accuracy of the records;
- b) ensuring that the institution maintains proper accounting records and for preparing financial statements that:
  - comply with the institution's Instrument and Articles, all statutory requirements relating to the institution's financial affairs, the Financial Memorandum, any other requirements of the Welsh Assembly Government, and any other regulations relating to the constitution and activities of the institution which are relevant to its financial affairs;

- show a true and fair view of the state of the institution's affairs at 31 July and of the income and expenditure, recognised gains and losses and cashflows of the institution for the year then ended, taking into account where relevant and appropriate all required statutory and other disclosure requirements; and
  - c) preparing other returns in accordance with Welsh Assembly Government instructions.
4. The institution will send copies of the audited financial statements to the Governing Body, to its Audit Committee and to the Welsh Assembly Government.

## Reporting

5. We, as auditors:

- a) are responsible for reporting to the Governing Body on the periodic financial statements, which are laid before the Governing Body in respect of our tenure of office;
- b) are required to provide an audit report on returns as required by Welsh Assembly Government, which should be consistent with our audit report on the institution's financial statements.

6. We will also report to the Governing Body whether monies, expended out of Welsh Assembly Government grants and other funds from whatever source administered by the institution for specific purposes, have been properly applied to those purposes and, if appropriate, managed in compliance with all relevant legislation.

## Access

7. We expect to have access to the internal auditors' files and working papers. We agree to comply with any request from the PAGS, with the consent of the institution, to provide access to any relevant files and working papers obtained or prepared by us as auditors of the institution. The PAGS will exchange letters, where necessary, with both parties which deal with confidentiality and the terms under which access is given.

8. We shall have the right of direct access to the Chair of the Audit Committee, the right to require the Chair to convene a meeting of the Audit Committee if necessary and the right to attend Audit Committee meetings where relevant business is to be discussed.

## **Annual Meetings**

9. We will be entitled to attend the institution's meeting, at which its annual reports and financial statements of account are presented and to receive all notices of, and other communications relating to, such a meeting, which any member of the Governing Body is entitled to receive and to be heard at any such meeting, on any part of the business which concerns us as auditors.

## **Termination of Appointment**

10. In the event of serious shortcomings on our part, the Governing Body may, by resolution, remove us before the expiration of our term of office, without compensation, notwithstanding any agreement between us and the institution.

## Annex J

# Guidance on the process for Market Testing of Internal and External Audit

1. The Code recommends that institutions should consider market testing their internal and external audit services at least every five years. In this way institutions can periodically reassess whether they are obtaining value for money from their audit providers and whether there are benefits to be realised through a change.
2. There are a number of ways of procuring an internal audit service which would meet the requirements of the Financial Memorandum. These are:
  - a) appoint an 'in-house' team. This may also be supplemented, from time to time, with external consultants or contractors, under the direction of the internal auditor, to meet any peaks in workload or provide specialist skills; or
  - b) contract with an external provider. Where an external provider is contracted to deliver internal audit services, this will preclude the provider from delivering external audit services. This requirement is necessary to enable the objective review of internal audit by external audit.
3. Market testing should be conducted in accordance with institutions' financial regulations and procurement procedures. This will normally involve a competitive tendering exercise through which the institution can explore the market for such services by inviting providers to bid on the basis of a detailed contract specification.
4. Institutions will also need to ensure they comply with EC Procurement Directives where these apply. Guidance on how a competitive tendering exercise should be conducted is set out below.

### Timing

5. Market testing should take place as far in advance of the start date of the contract as possible, to allow for continuity of service and to allow the new auditors sufficient time to prepare properly for their work. Contracts should normally be coterminous with the year end of the institution.

## The Tender Process

6. Preparation of the contract specification is a key element in the market testing process. The specification should be clear and concise with sufficient detail to enable audit providers to assess accurately the institution's requirements. The information provided should include:

- a) an indicative audit needs assessment, to be reviewed by the incoming internal auditor on appointment;
- b) details of the regularity framework under which the auditor would be expected to operate;
- c) details of the institution.

Only in this way can institutions ensure that bids for the contract are made on a consistent basis and are comparable. It will also ensure that contracts are not subject to excessive variations where the institution has to flex the contract to meet unplanned needs.

7. Preparation of the contract specification will normally require some specialist input on finance and audit issues. Therefore, it should usually involve the institution's Finance Director or equivalent.

8. Where the institution establishes a Review Panel to oversee the market testing process the Panel should also be involved in the preparation of the contract specification.

9. The Audit Committee will be responsible for overseeing the provision of audit services to the institution under its terms of reference approved by the Governing Body. Therefore, the Committee should approve the contract specification and will be more closely involved in its preparation where a review panel has not been established.

10. The tender documentation should also include or refer to the proposed terms of reference under which the institution will require the audit provider to operate. For external audit, this will normally be the model letter of engagement incorporating the paragraphs shown at Annex I. For internal audit this will normally be the model terms of reference shown at Annex F.

11. The institution's financial regulations or procurement procedures should specify how audit providers will be invited to bid. This should normally be through open advertisement or the use of a select list. Whatever the method, the Audit Committee or Review Panel should agree selection criteria that enable it to assess the appropriateness of audit providers and the quality of service on offer. In making its recommendation to the Governing Body, the Audit Committee should seek to obtain the best value for money for the institution.

12. Tender bids should be sought from at least three providers. A reserve list of possible providers may be earmarked. At this stage in the proceedings, the institution may invite providers to discuss the tender documents to clarify any points of uncertainty. The institution should take care to ensure that the same access is granted to all providers invited to bid.

13. Tender bids should be evaluated by the Review Panel or Audit Committee, against the predetermined selection criteria. This may include inviting the audit providers to make presentations of their proposals. The evaluation should be documented to provide a formal record of the process and the final selection.

14. The selection criteria may include, inter-alia:

- a) qualifications including, for external audit, those set out in Schedule 7 of the Education Reform Act 1988;
- b) experience, both general and specific to the institution. This may relate to the audit provider and individual auditors;
- c) overall price, price per audit day or price per auditor grade;
- d) perceived quality in terms of the mix of audit grades proposed;
- e) the range of services on offer, particularly specialised areas such as computer audit, contract audit and value for money work;
- f) geographical location, where there are perceived benefits from local service delivery; and
- g) specific terms, such as proposals to restrict liability.

## **Approval**

15. Once a selection has been made it should be recommended to the Governing Body for acceptance and approval.

## **Contracts**

16. The institution should ensure that formal contracts are signed with the appointed auditors. These contracts may be signed by the Principal, or other delegated officer, on behalf of the institution.

## **The PAGS**

17. On appointment, institutions should inform the PAGS Head of Provider Audit and Governance of their selection and provide a contact point for future dealings.

18. Institutions may seek advice from the PAGS on any aspects of process during any market testing exercises.



## Annex K

### Reportable Events Guidance

1. Following consultation with the sector, the former Further Education Funding Council issued its original guidance on the definition of Reportable Events to the sector in May 1999. The aim of the definition was to ensure that the Council became aware of events in a timely manner and to facilitate additional monitoring where this was deemed necessary.

2. This guidance still applies and has been reissued by the WAG in the form of an Audit Related Letter (ARL/FE/20). The detailed guidance is reproduced below:

#### **Reportable Event**

Without prejudice to the terms in the Financial Memorandum, the Audit Code of Practice or any other instrument which require the institution to inform the Department for Children, Education, Lifelong Learning and Skills in advance, or immediately on occurrence, of specific events which may impact on the financial position of the institution or the security of its assets, the institution is required to inform the Department for Children, Education, Lifelong Learning and Skills immediately of any event or circumstance which is expected to, or anticipated may, significantly alter the institution's financial situation.

This should include:

- a) all events or circumstances that either significantly restrict or increase the level of the institution's income or expenditure or its operations and service provision;
- b) events that significantly change the nature or delivery of provision;
- c) events that significantly change the organisation and structure of the institution;
- d) events that affect the institution's ability to produce adequate management information; and
- e) changes in the key positions listed.

"Significant" is not defined in this context as, in practice, it will vary between institutions. Designated Office Holders will be required to exercise judgement and discretion in deciding what events to report. Where there is doubt, events should be reported.

An illustrative list of events and circumstances that should be reported is provided below:

- changes in the positions of the Chair of Governors, Chair of Audit Committee, Principal, Director of Finance (or equivalent) and Clerk to the Governing Body. This should include situations of prolonged periods of absence.
- significant changes in forecast financial position and cash flow projections where these indicate a deterioration in financial position, including significant variations between actual results and forecasts.
- significant litigation, judgements or claims against the institution.
- significant restructuring projects involving changes to staffing and/or physical infrastructure.
- significant estates projects or problems arising, particularly involving health and safety issues and/or unforeseen commitments.
- divergence into new areas of activity.
- planned self funding activities that run into deficit.
- any other events that are considered to be novel and/or contentious by their size and nature.

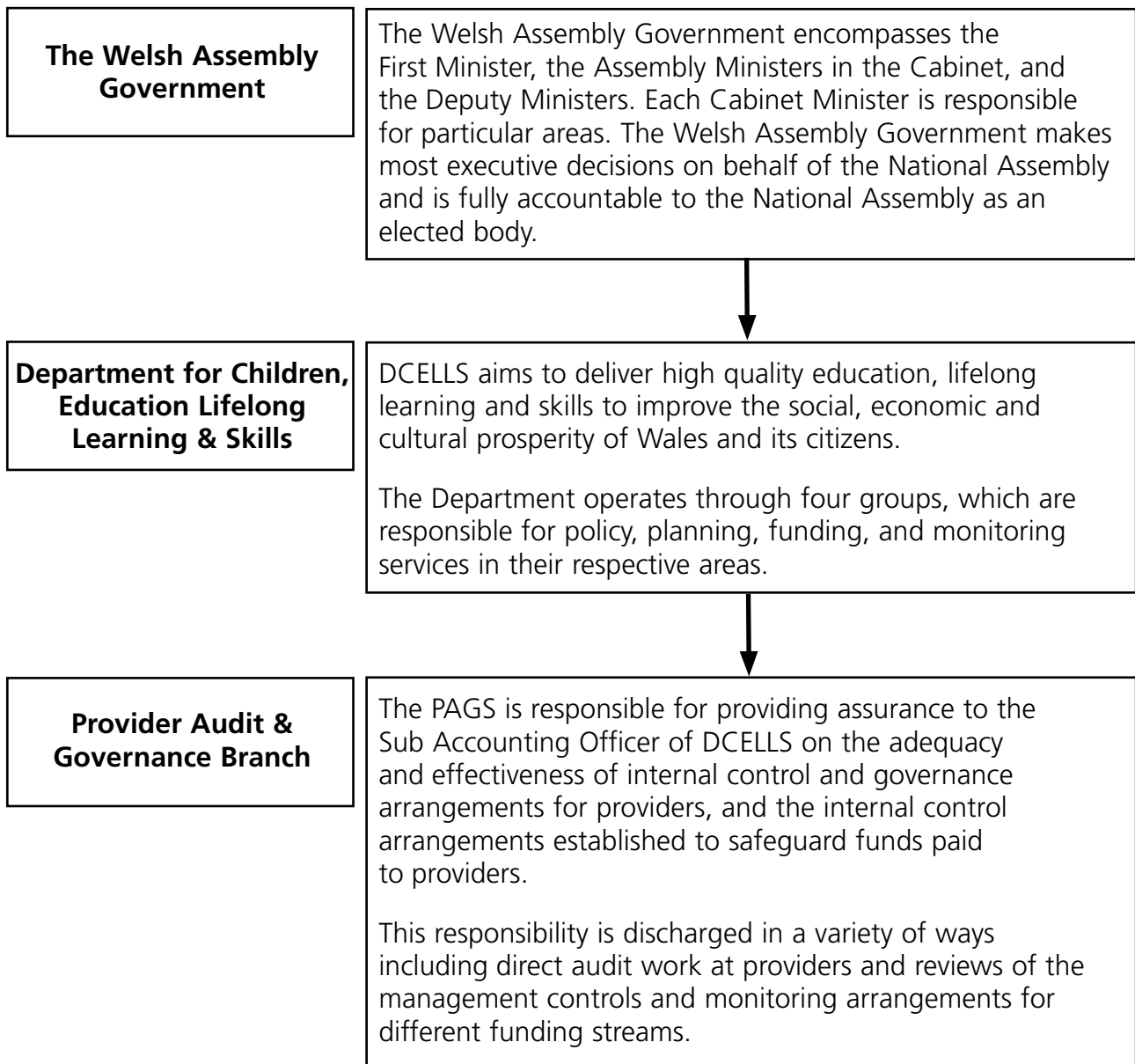
### **This List is not Exhaustive**

All reportable events falling within the above criteria should be notified to:

Head of Provider Audit and Governance  
Department for Children, Education, Lifelong Learning and Skills  
Tŷr Afon  
Bedwas Road  
Bedwas  
Caerphilly  
CF83 8WT

# Annex L

## Department for Children Education Lifelong Learning and Skills



## Annex M

### Glossary of Terms

|                         |  |
|-------------------------|--|
| DCELLS                  | Department for Children, Education, Lifelong Learning and Skills   |
| Designated Officer      | Principal of the Institution   |
| GIAS                    | Government Internal Audit Standards  |
| Governing Body          | Corporation Board  |
| HEFCW                   | Higher Education Funding Council for Wales   |
| Institutions            | Further Education institutions and designated institutions   |
| Internal Control System | The whole network of systems established in an organisation to provide reasonable assurance that organisational objectives will be achieved, with particular reference to:<br><ul style="list-style-type: none"><li>a) the effectiveness of operations;</li><li>b) the economical and efficient use of resources;</li><li>c) compliance with applicable policies, procedures, laws and regulations;</li><li>d) the safeguarding of assets and interests from losses of all kinds, including those arising from fraud, irregularity and corruption;</li><li>e) the integrity and reliability of information, accounts and data.</li></ul> |
| LSC                     | Learning and Skills Council  |
| Principal               | Principal, Chief Executive or equivalent   |
| PAGS                    | Provider Audit and Governance Service  |
| SFC                     | Scottish Funding Council   |
| WAG                     | Welsh Assembly Government  |
| WAO                     | Wales Audit Office   |