Annex A
Mandatory requirements of the Financial Memorandum and Accountability and Audit Code of Practice

1. The following are mandatory requirements of the Financial Memorandum (FM) and the Accountability and Audit Code of Practice (the Code), and we will assess compliance with these.

2. The governing body must ensure that the institution meets its responsibilities as set out in paragraphs 23 to 29 of the FM.

3. The institution must obtain written consent for financial commitments, as specified in Annex F to the Financial Memorandum.

4. The governing body of each HEI must take reasonable steps to ensure that there are sound arrangements for risk management, control and governance, and for economy, efficiency and effectiveness (value for money), within the HEI.

5. Each HEI must have an effective audit committee, which produces an annual report for the governing body and the designated officer. The audit committee annual report must relate to the financial year and include any significant issues up to the date of preparing the report which affect the opinion. The audit committee annual report must include the audit committee's opinion on the adequacy and effectiveness of:

- the HEI's risk management, control and governance arrangements
- arrangements for promoting economy, efficiency and effectiveness
- data management and quality assurance.

6. Members of the audit committee must not have executive authority. Members should not also be members of a finance committee, unless the institution's governing body has made a clear decision to allow no more than one audit committee member (not the chair) to sit on both.

7. The audit committee of each HEI, advised where appropriate by its internal audit service, must satisfy itself that satisfactory arrangements are in place to promote economy, efficiency and effectiveness.

8. Each HEI must have an effective internal audit function, which reports regularly to the audit committee and at least annually to the governing body and the designated officer. The internal audit annual report must relate to the financial year, and include any significant issues up to the date of preparing the report which affect the opinion.

9. The work of the internal audit service must cover the whole of the risk management, control and governance arrangements of the HEI.

10. The head of the internal audit service must have direct access to the HEI's designated officer, the chair of the audit committee and, if necessary, the chair of the governing body. Internal, as well as external auditors, must also have unrestricted access to information – including all records, assets, personnel and premises – and be authorised to obtain whatever information and explanations the head of the internal audit service or the external auditor considers necessary.

11. Internal audit and external audit services must not be provided by the same firm or provider.

12. Fees paid to external auditors for other services must be disclosed separately in a note in the financial statements.

13. Subject to legislative constraints, the HEFCE assurance service must have unrestricted access to information – including all records, assets, personnel and premises – and can require anyone to give any explanation which it considers necessary to fulfil its responsibilities. This includes access to any work of the internal auditors and the external auditors, or correspondence between internal and external auditors. For access to external audit work, the HEFCE assurance service will exchange letters (where necessary) with both parties to deal with confidentiality and the terms under which access is given.

14. HEIs must not agree to any restriction in external auditors' liability in respect of the external audit of their annual financial statements, unless a liability limitation agreement has been entered into.

15. The following information must be provided, according to a timetable which will be notified each year:

- a signed and approved set of financial statements
- a copy of the audit committee's annual report
- a copy of the internal auditors' annual report
- the completed annual assurance return (Annex E of the FM)
- a copy of the external auditor's management letter and any management response.

16. The HEI's designated officer must report any material adverse change – such as a significant and immediate threat to the HEI's financial position, significant fraud or major accounting breakdown – without delay to the chair of the HEI's audit committee, the chair of the HEI's governing body, the HEI's head of internal audit and the HEFCE chief executive.

17. The governing body must inform HEFCE's assurance service without delay of the removal or resignation of the external or internal auditors.

Annex B
Accountability and Audit: Code of Practice

Summary of proposed changes to Accountability and Audit: Code of Practice

The principal proposed changes to the current version of the Code published in 2004 (HEFCE 2004/27) are as follows:

- We intend to publish the Code on the HEFCE web-site as an annex to the Financial Memorandum, to emphasise that compliance with the Code is a condition of grant.
- This Code will apply to the period in which HEFCE's new accountability framework, including the single conversation, will take effect. In due course the overall HE accountability framework will need also to enable HEFCE to discharge the responsibilities it will have as principal regulator of HEIs as exempt charities.
- There is one new proposed mandatory requirement: we are seeking assurance about the management and quality assurance of data submitted to HESA and HEFCE (paragraphs 52 and 66).
- We intend to remove prescriptive and advisory text and instead point readers to authoritative sources of information and guidance on:
  - corporate governance where reference to the CUC Code of Practice removes the need for the old paragraphs 20-25
  - HEFCE's own audit practices; these have changed radically, and HEFCE Circular Letter 25/2006 supersedes paragraphs 43, 44, 51, 52 and 56-65 in HEFCE 2004/27
  - institutions' audit committee practice where instead of old paragraphs 68-84 we propose to endorse CUC's audit committee handbook (to be published in early 2008)
  - institutions' internal audit practice where we more clearly commend the standards of the Institute of Internal Auditors; this removes the need for old paragraphs 93, 94, 99-101, 103, 104, 109, and 115-117.
- We are clarifying that there may be circumstances in which the Public Accounts Committee could require the chair of a governing body to appear before it (paragraph 22).
- We are removing the requirement for cross-membership between an institution's audit and finance committees to be approved by HEFCE (paragraph 50).
- Where internal audit is provided in-house we are recommending that the nature of the provision should be subject to periodic reappraisal; this will bring the review of in-house internal audit in line with that for contracted provision (paragraph 70).
- We are commending institutions to fresh guidance on the pursuit and measurement of value for money (VFM) (see Appendix to Annex B).
- We are endorsing as good practice guidance from the Audit Commission on the

management and quality assurance of data (paragraph 6).

- We are deleting some of the annexes to the current Code which are not needed given our advocacy of other authoritative sources of audit practice.
- We have updated our annual assurance return from designated officers and made this an annex to the FM rather than the Code.

Draft Accountability and Audit: HEFCE Code of Practice

Executive summary

Purpose

1. This Code sets out our requirements for higher education institutions' (HEIs') accountability and audit arrangements and the broad framework in which they should operate. The Code is now published on the HEFCE web-site only. Its status is that of an annex to the Financial Memorandum and is therefore a condition of grant.

Key points

2. This Code replaces the 2004 version of the Audit Code of Practice (HEFCE 2004/27) with effect from 1 August 2008. Its contents reflect the new accountability framework published in 2007 (HEFCE 2007/11).

3. This revised Code is the outcome of a review and consultation process undertaken in 2007-08 which resulted in a new Financial Memorandum (FM). The FM is the central accountability document, and this Code and other ancillary documents are published on the HEFCE web-site.

4. The Code has been streamlined to focus on the mandatory reporting requirements which institutions need to comply with. It now gives less detailed specifications for how audit arrangements in institutions should operate, and instead points readers to established and authoritative sources of guidance.

<u>Context</u>

5. This update of the Code comes at a time when the funding position of institutions in England is changing to a considerable degree. Since the previous version in 2004, public investment in the sector has risen but so has that from other sources, notably the full-time undergraduate students who now pay a higher fee. Whoever is paying for HE, they all expect accountability. At the same time the imperative for better regulation is accepted by all parties, which means that regulatory interventions have to be optimised. There is also considerable pressure on HEFCE and other public bodies to operate as efficiently as possible, and this means that we have to continue to streamline the way our audit and assurance staff operate. Finally, HEFCE is to be designated as the principal regulator of HEIs as charities; although the implications of this had not been finalised as this Code was in preparation, it will clearly be important to operate the HE accountability framework in an effective manner. Taken together, these factors mean that we must have the best

possible balance between accountability and autonomy. For this to be achieved governors, managers and auditors in institutions need to meet their obligations under the Code.

New requirement

6. The only additional requirement in this new Code is that we are seeking assurances from designated officers, internal auditors and audit committees about the management and quality assurance arrangements for data submitted to HESA and HEFCE. This is imperative in order to improve the reliability of data which is crucial for the efficiency of our funding and to reduce the number of significant funding adjustments needed to correct data errors. We endorse guidance on the principles of data management for public bodies as published by the Audit Commission, 'Improving information to support decision making: standards for better quality data' (www.audit-commission.gov.uk, November 2007).

HEFCE chief executive

7. HEFCE's chief executive is its accounting officer. He is responsible for ensuring the proper and efficient use of public funds by HEFCE, by HEIs and by others who receive HEFCE funds, and for ensuring that Treasury guidance is observed. The financial memorandum between the Department for Innovation, Universities and Skills (DIUS) and HEFCE requires the issue of an audit code of practice for institutions. This is that Code.

Introduction

8. This Code states how effective accountability and audit coverage should be achieved. It sets out our minimum requirements for the reporting of risk management, control and governance arrangements, for internal and external audit arrangements, and the broad framework in which they should operate.

9. The Code applies to the relationship between HEFCE and higher education institutions – and in principle to their related companies and other bodies which, indirectly, receive HEFCE funding. These include, for instance, subsidiary entities of HEIs – such as subsidiary companies, student unions and charitable funds – and they should pay appropriate regard to the Code. We also fund a small number of connected institutions through HEIs, which are also subject, indirectly, to this Code. The colleges of the universities of Oxford and Cambridge are not funded directly by us but are subject to an agreed audit protocol.

10. We also fund and have relationships with a number of related bodies. These are independent bodies established to assist HEFCE and the HE sector to deliver HE strategy. Each related body is required as a condition of its funding with HEFCE to conform to this Code.

11. There are a number of mandatory requirements which are conditions of funding under the Financial Memorandum between HEFCE and HEIs. These are set out in Annex A of the FM.

12. We may update the Code on the HEFCE web-site at any time. We will consult sector stakeholders about significant changes, particularly where they affect mandatory requirements. We may also supplement the Code with occasional circular letters specifying guidance and requirements. They will be developed in consultation with the representative bodies in HE, and will be incorporated into any subsequent revision of the Code.

13. We assess institutions' performance against this Code in two ways. Firstly, every report and return required under this Code, from each institution, is scrutinised on an annual basis by the HEFCE assurance service. Where institutions fail to report as required it is classed as non-compliance with conditions of grant. Secondly, each institution is subject to a brief five-yearly review to assess the extent to which its accountability performance can be relied on. This leads to an agreed report which is publicly available (more details are in HEFCE Circular Letter 25/2006).

14. The Code is primarily for use by internal and external auditors, HEIs' senior management, members of the governing body and audit committees. It may also be of interest to other stakeholders. More detailed advice on any aspect of the Code is available from the HEFCE assurance service.

Corporate governance

15. The corporate governance arrangements of an HEI are the means by which strategy is set and monitored, the executive is held to account, risks are managed, stewardship responsibilities are discharged and sustainability is ensured. A more complete description of corporate governance in a HEI can be found in the guide by the Committee of University Chairmen (CUC) – 'Guide for Members of Higher Education Governing Bodies in the UK' (HEFCE 2004/40). The responsibilities of a governing body as to conditions of HEFCE funding can be found in the Financial Memorandum.

16. The CUC Guide includes a Governance Code of Practice which CUC and HEFCE commend institutions to evaluate themselves against. The principle should be that institutions 'comply or explain' and the outcome of each periodic evaluation should be published, ideally in the Corporate Governance Statement or Statement on Internal Control in the published financial statements.

Higher education audit framework

17. In accordance with the Financial Memorandum, HEIs must have effective risk management, control and governance arrangements. Other public bodies also have an interest in these control arrangements, including Parliament, DIUS, Learning and Skills Council (LSC), UK Research Councils, Department for Employment and Learning (DEL) in Northern Ireland, and Training and Development Agency for Schools (TDA).

18. Each of these bodies makes appropriate arrangements to safeguard its interest. Each has its own auditors; however in practice there are only two groups engaged in regular audit investigation of an institution's systems and records – an institution's

internal and external auditors. This is the same level of activity that is common in the private sector. Of the interested parties, DIUS, HEFCE, LSC, DEL, TDA and the UK Research Councils seek to avoid duplication by relying on the work of the other bodies' auditors whenever possible.

Parliament

19. Parliament's interest is to see that public funds are properly applied and accounted for and used economically, efficiently and effectively by recipients. The Comptroller and Auditor General, head of the National Audit Office (NAO), is the external auditor of HEFCE. He has the right to inspect the accounts of any HEI that receives HEFCE grant, and the right to carry out value for money investigations. The NAO is highly selective in its use of inspection rights: most of its audit work is undertaken at HEFCE, and value for money investigations normally involve only a sample of institutions at any one time.

Department for Innovation, Universities and Skills (DIUS)

20. Public funds are channelled through DIUS. The DIUS Permanent Secretary, as accounting officer, is responsible and accountable to Parliament. The HEFCE chief executive must be satisfied that proper arrangements are being made to safeguard public funds. This is achieved through the financial memorandum between DIUS and HEFCE, which requires HEFCE to have an audit service and appropriate accounting systems. The work of HEFCE auditors is examined by the DIUS audit service, which may observe it at work in HEIs but does not audit HEIs itself.

HEFCE

21. Under the financial memorandum with DIUS, HEFCE's chief executive is accounting officer for the funds received from DIUS and is accountable to Parliament for them. This applies both to money we spend directly on our own operation, and to money spent by the HEIs and other entities that receive HEFCE funds. The HEFCE assurance service accordingly provides both the internal audit function within HEFCE, and assurance to the HEFCE chief executive on the arrangements within HEIs and other HEFCE-funded entities. This Code is principally concerned with the latter part of the service, namely arrangements in HEIs and other HEFCE-funded entities. However, the internal audit of HEFCE's arrangements is carried out in accordance with these same standards. In common with the arrangements in HEIs, there is an audit committee to assist the HEFCE chief executive and Board in discharging its accountability and audit responsibilities, in respect of both HEFCE, and HEIs and other entities.

22. The governing body of an HEI is responsible for ensuring the proper use of public funds. Under the Financial Memorandum with HEFCE the governing body is required to designate a principal officer known as the designated officer. Normally the governing body will designate the institution's vice-chancellor, principal or equivalent. He or she should satisfy the governing body in respect of the use of public funds, and may be required to appear before the Public Accounts Committee of the House of Commons, alongside HEFCE's chief executive, on matters relating to the use of HEFCE funds. The chair of the governing body may also be required to appear before the Public Accounts Committee.

23. In the event of any serious weakness, such as a significant and immediate threat to the HEI's financial position, significant fraud or major accounting breakdown, the designated officer must inform, without delay, the chair of the HEI's audit committee, the chair of the HEI's governing body, the HEI's head of internal audit and the HEFCE chief executive. On receiving any such notification, the chief executive will discuss what response to make with the HEI's governing body or designated officer, including any action to be taken. If a matter requiring report is discovered by external or internal auditors in the normal course of their work and the designated officer refuses to make a report, the auditors must report directly to the chair of the HEI's audit committee, the chair of the HEI's governing body and the HEFCE chief executive. This is to ensure that the HEI has taken appropriate action.

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

- the sums of money involved are, or potentially are, in excess of £20,000
- the particulars of the fraud or irregularity are novel, unusual or complex
- there is likely to be public interest because of the nature of the fraud or irregularity, or the people involved.

25. There may be cases of serious weakness that fall outside this definition. In these cases or any others, HEIs can seek advice or clarification from the HEFCE assurance service. In view of the public interest, HEIs should normally notify the police of suspected or actual fraud. Where the police are not notified, management should advise the institution's audit committee of the reason. HEIs are also referred to the guidance on fraud we issued in 1999 (HEFCE 99/65, available on the HEFCE web-site).

Learning and Skills Council and the Training and Development Agency

26. Some HEIs receive funds from the LSC or the TDA, who therefore also have an interest in their management and accountability. To avoid unnecessary duplication, the LSC and TDA will rely on the accountability and audit framework set out in this Code. They are not directly involved in auditing HEIs, except that they may occasionally request specific audit work to be undertaken in accordance with their own funding conditions. HEFCE and the LSC have a formal protocol for this work, and it is reflected in an annual exchange of assurances between the chief executives.

General principles for internal and external auditors

Duties

27. These general principles for auditors are intended to supplement, not replace, those issued by the recognised professional bodies (including the Ethical Standards issued by the Auditing Practices Board), which we expect auditors to also follow. The principles set out our requirements for the standards for HEIs' internal and external auditors, and are the standards to which our own auditors operate, in recognition of the

high level of probity demanded where public funds are involved.

Objectivity

28. Auditors should ensure that the HEI’s audit committee is appropriately informed on a timely basis of all significant facts and matters that bear upon the auditors’ objectivity and independence. In particular, auditors should avoid the following:

a. Official, professional and personal relationships which might cause the auditor to limit the extent or character of the audit.

b. Any responsibility for the executive management of the HEI.

c. Any interest, financial or non-financial, direct or indirect, in the HEI (other than the normal employee or contractor relationship, or the funding of any prize, scholarship or academic appointment).

29. Notwithstanding the need for objectivity, the external and the internal auditors of an HEI should aim to ensure that their work programmes complement each other to optimise the effectiveness of their services.

Dual appointments

30. Provision of both internal audit and external audit services to an HEI by the same firm or provider is not permitted under this Code, as this compromises auditors’ objectivity. The only permitted exception is where an external auditor carries out a limited amount of (typically specialist) work in support of the internal audit service, and the extent of this should be monitored by the audit committee.

31. External auditors need to form a view on the quality and coverage of the internal auditors’ work, to determine the extent to which they can rely on this to underpin their own work. It is not acceptable for a firm to provide an opinion as external auditor about the same firm’s work as internal auditor. Governors and managers need such opinions to be objective and independent. It is also useful to governors and managers to obtain two independent views on risk management, control and governance, reflecting the different perspectives of internal and external auditors.

Due professional care

32. Internal and external auditors are expected to exercise due professional care in their work and should refer to the published standards of their professional bodies (ICAEW, ACCA, CIPFA, IIA) for further guidance.

Audit and risk assessment of HEIs by the HEFCE assurance service

Role and scope

33. The HEFCE assurance service is responsible for evaluating the risk management, control and governance arrangements of HEIs and other entities funded by HEFCE, and for giving assurance on those arrangements to HEFCE’s chief executive.

34. All the activities of HEIs are within the remit of the HEFCE assurance service (HEFCEAS). The HEFCEAS works in accordance with the standards for internal audit in

the Government Internal Audit Standards issued by the Treasury, and guidance from relevant professional auditing and accountancy bodies. It will consider whether risk management, control and governance arrangements are adequate to manage risk and to secure propriety, efficiency, economy and effectiveness in all areas. It will seek to confirm that management has taken the necessary steps to achieve these objectives.

35. Subject to legislative constraints, the HEFCEAS has access to all records, information and assets of HEIs and other entities, and can require any officer, including members of the governing body, to give any explanation which it considers necessary to fulfil its responsibilities.

36. The HEFCEAS will liaise, whenever appropriate, with the National Audit Office, the HEIs' internal and external auditors (collectively and individually), the DIUS, TDA, Scottish Funding Council, Higher Education Funding Council for Wales, DEL and any other appropriate HEFCE officer or relevant organisation. The HEFCEAS will also liaise with sector bodies as it seeks to promote good governance, management and auditing. Liaison is pursued both for effectiveness and to avoid duplication of effort.

Reporting

37. The HEFCEAS will report on HEIs' compliance with the relevant standards to HEFCE's chief executive and audit committee. The HEFCE audit committee will also consider, and advise the chief executive on, any assessments of the HEFCEAS, including any reports that have been specially commissioned and any by the DIUS head of internal audit.

38. The HEFCEAS will, when appropriate, draw the attention of the HEFCE chief executive and audit committee to serious weaknesses, significant frauds and any major accounting breakdowns.

39. The HEFCEAS will submit an annual report to HEFCE's chief executive and audit committee. This will include the HEFCEAS's assessment of the adequacy and effectiveness of the risk management, control and governance arrangements within HEIs and other entities funded by HEFCE; report on coverage achieved; and provide audit performance measures.

Ongoing risk assessment

40. We expect HEIs to notify us of significant changes and issues as they arise. This will help us to maintain the currency of the risk assessment. For example, changes of auditors, of key personnel (such as the finance director, or university secretary/registrar) or key systems changes (such as the implementation of a new finance information system) are potentially significant in our risk assessment. We also need to be notified of material adverse changes in performance, such as under-recruitment, that could impact our assessment.

Annual accountability assessment

41. Every year the HEFCE assurance service will assess the extent to which each HEI's audit and related reports, supported by any other relevant information, demonstrate the effectiveness of risk management, control and governance arrangements. The work will take place after receipt of HEIs' financial statements and other audit returns (the 'single conversation'). The conclusions from the assessments will be taken into account when HEFCE makes its overall risk assessment of each HEI, and will be reflected in the resultant annual letter notifying our risk assessment to the HEI's designated officer. Where HEIs' reports are not provided to us, or where they reveal inconsistencies or other concerns, we will take appropriate action. This may include the HEFCE assurance service undertaking audit work or asking for audit work to be done.

42. The specific sources of assurance that influence our assessment include the financial statements and reports of the audit committee and the internal and external auditors; the detailed requirements will be published each year. In addition we will require the annual assurance return from the designated officer which confirms compliance with the FM (see Annex E to the FM). Note that a new specific assurance on data quality is required as part of this return.

HEFCE assurance reviews at institutions

43. The HEFCE assurance service undertakes reviews at institutions with the objective of determining whether the institutions' reports and returns, including those specified in this Code, can be relied on. Where this is so, and an institution continues to perform well and sustain itself, the HEFCEAS will only need to undertake its brief review once in every five-year cycle. The review is discussed in detail in Circular Letter 25/2006.

44. In adopting a risk-based approach, the HEFCE assurance service will need to undertake more frequent reviews or conduct different sorts of enquiries if an institution does not meet its obligations under this Code or gets into difficulty. There are a range of possible HEFCE engagements with institutions at risk, and these are set down in our institutional engagement and support strategy (see Annex D).

Data audits

45. HEIs are required to supply us with data to inform our allocations of funding generally, and in response to specific initiatives. To avoid duplication we will wherever possible use data that are already supplied through the Higher Education Statistics Agency (HESA). We have procedures for validating and verifying data. We also undertake data audit work in each institution. From 2008-09 we aim to audit data in each institution once every five years. The work will be risk-based, in that we will tailor our coverage to reflect the data record, risks and materiality of different areas of funded activity in each HEI.

Value for money

46. 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 is obtained. This

duty falls on HEFCE and on the HEIs that we fund. Further guidance on this subject is available in the Appendix below.

Audit committees in HEIs

Scope

47. The governing body of an HEI must ensure that it is fulfilling its responsibilities for adequate and effective risk management, control and governance, and for the economy, efficiency and effectiveness (or VFM) of the HEI's activities. To assist in this, each HEI has appointed an audit committee.

Operation

48. The way an audit committee in an HEI should operate and be constituted is set down in guidance from the Committee of University Chairmen to be published in early 2008.

49. HEFCE's position is that governing bodies and audit committees should conduct themselves in line with the CUC's principles and practices, and that where they differ then this should be explained and made public. Overall we aim to be content to rely on the accountability provided by an audit committee following CUC practice and by a governing body able to exercise accountability on behalf of external investors. We therefore support the principle of an external majority on a HEI governing body.

50. Audit committee members should not be members of a finance committee or its equivalent. This creates the potential for a conflict of interest when the audit committee is considering decisions involving the finance committee. If an HEI's governing body determines that a minimal cross-representation is essential, this should be the subject of an explicit, recorded resolution – but it should not be an option for the chair of either committee.

Reporting

51. The audit committee must produce an annual report for the governing body and the designated officer. The audit committee annual report must cover the financial year and include any significant issues up to the date of preparation of the report. The audit committee annual report should normally be submitted to the governing body before the members' responsibility statement in the annual financial statements is signed. The internal auditor's annual report as well as the audit committee report must be submitted to the HEFCE assurance service according to the timetable to be published annually in a circular letter. This informs our institutional risk assessment.

52. The audit committee annual report must include the committee's opinion on the adequacy and effectiveness of the HEI's arrangements for the following:

- risk management, control and governance
- economy, efficiency and effectiveness (value for money)
- management and quality assurance of data submitted to HESA and to HEFCE and other funding bodies.

This opinion should be based on the information presented to the committee.

53. The report should also record the work of the committee, and consider the following:

- the external auditors' management letter
- the internal auditors' annual report
- value for money work
- any HEFCE assurance service or other relevant evaluation.

54. The report might also identify any key issues for the HEI arising out of its activity over the year.

Internal audit arrangements in HEIs

55. Each HEI is required by its Financial Memorandum with HEFCE to have an internal audit function.

56. Treasury guidance is that a risk-based approach to internal audit should be adopted within the public sector, specifically including the HE sector, and we have taken this approach. The guidance is reflected in the Government Internal Audit Standards (GIAS), published by the Treasury in October 2001. The introduction of risk management in the sector, following the adoption of the revised Combined Code and associated principles from other sectors, has brought considerable change in the approach to governance, management and internal audit – moving away from a purely systems-based approach to one which primarily reflects inherent and perceived risk.

57. HEFCE guidance on internal audit practice in HEIs is that we endorse the approach set out in GIAS and that set out in the Code of Ethics and International Standards (March 2004) of the Institute of Internal Auditors (IIA) and that organisation's Position Statement on Risk Based Internal Auditing (August 2003). Both of these documents are available from the IIA (www.iia.org.uk). Accordingly, we do not include in this Code detailed guidance on the practice of internal audit.

58. Within the HE sector the prime responsibility of the internal audit service is to provide the governing body, the designated officer and the other managers of the HEI with assurance on the adequacy and effectiveness of risk management, control and governance arrangements. Responsibility for these arrangements remains fully with management, who should recognise that internal audit can only provide 'reasonable assurance' and cannot provide any guarantee against material errors, loss or fraud. Internal audit also plays a valuable role in helping management to improve risk management, control and governance, thereby reducing the effects of any significant adverse risks faced by the HEI.

59. Internal audit can also provide independent and objective consultancy advice specifically to help management improve risk management, control and governance,

thereby contributing to the achievement of corporate objectives. Such advisory work contributes to the opinion which internal audit provides on risk management, control and governance.

Operation

60. An HEI must ensure that it has effective risk management, control and governance arrangements. These help to ensure:

a. That the HEI’s objectives are achieved as far as possible and that associated risks are managed.

b. That the economic, efficient and effective use of resources is promoted.

c. That there is adherence to management’s policies, directives and established procedures, and compliance with any relevant laws or regulations including charities legislation.

d. That the HEI’s assets and interests are safeguarded – particularly from losses arising from fraud, irregularity or corruption.

e. That, as far as reasonably practicable, the integrity and reliability of accounting records, data and other information are maintained.

61. Accordingly, the internal audit service must consider the whole of the HEI’s risk management, control and governance arrangements, including all its operations, resources, staff, services and responsibilities for other bodies. It should cover all activities associated with the institution, including those not funded by HEFCE. For example, it should consider controls that protect the HEI in its dealings with any subsidiary or associated company or student union, or any other activity in which the HEI has an interest.

62. Internal auditors should also assess the adequacy of the arrangements to prevent and detect irregularities, fraud and corruption. However, the primary responsibility for preventing and detecting corruption, fraud and irregularities rests with management, who should institute adequate systems of internal control, including clear objectives, segregation of duties and proper authorisation procedures.

63. Internal auditors may carry out additional work at the request of management, including investigations, provided such work does not compromise the objectivity of the audit service or the achievement of the audit plan. Accordingly, each HEI’s audit committee should satisfy itself that the objectivity of the internal audit service has not been affected by the extent and nature of other work carried out. Internal audit services should not have any management responsibilities other than for internal audit.

64. Internal audit should be seen to have sufficient status, respect and support within the HEI. To be effective, the head of internal audit – or equivalent where the service is provided on a contract basis – must have direct access to the HEI’s designated officer and to the governing body (normally through the chair of the audit committee), and, if necessary, to the chair of the governing body. Whether provided internally or externally, day to day line management and overall reporting arrangements for the internal audit service should be such as to preserve its objectivity by avoiding concentration of

responsibility and reporting with any one senior person within the HEI. Internal auditors must also have unrestricted access to all records, assets, personnel and premises, and be authorised to obtain whatever information and explanations are considered necessary by the head of the internal audit service.

Reporting

65. The reporting requirements for any internal audit service are discussed in GIAS and in IIA standards. It is a mandatory requirement of this Code that the internal audit service produce an annual report of its activities. The internal audit annual report must relate to the financial year, and include any significant issues up to the date of preparing the report which affect the opinion. This should be addressed to the governing body and the designated officer, and should be considered by the audit committee. The audit committee may forward the report to the governing body with its own report. The report must be submitted to the HEFCE assurance service after it has been considered by the HEI's audit committee.

66. The internal audit annual report should include the internal auditor's opinion on the adequacy and effectiveness of the HEI's arrangements for:

- risk management, control and governance
- economy, efficiency and effectiveness
- the management and quality assurance of data submitted to outside agencies.

This opinion should be placed into its proper context: that is, the work undertaken has been based on the agreed audit strategy and on the areas reviewed in the year, as well as incorporating knowledge of areas audited in previous years (including from a previous auditor). Internal audit performance measures should be provided, including stating coverage achieved against the original audit plan. It should also draw attention to any significant audit recommendations which the internal audit service considers have not received adequate management attention.

Provision of service

67. There are a variety of ways to acquire an internal audit service, and we do not favour one approach above the others. One option is to appoint a head of internal audit and staff as necessary. An 'in-house' team may also be supplemented at a variety of levels by external consultants or contractors, under the direction of the head of internal audit, for instance to meet peaks in workload or to provide specialist skills.

68. Another option is to form a consortium with one or more HEIs, on a geographical or common interest basis. A consortium may be organised in-house, be provided externally or as a mixture of the two. A number of HEIs have set up such consortium arrangements.

69. A third option is to contract directly with an external provider, such as another HEI or an accountancy firm.

70. Each HEI, advised by its audit committee, should establish which is the most suitable and cost-effective way of obtaining internal audit services. However, every seven

years at least, it should consider market testing internal audit services where those services are provided by outside contractors, since this provides a powerful incentive to maintain quality and cost effectiveness. Where internal audit is an in-house service, there should be periodic consideration of whether this continues to be the appropriate type of provision for the institution. Advice on market testing can be obtained from the HEFCE assurance service.

71. In all cases the audit committee should monitor internal audit effectiveness as discussed in this Code. In addition, where the internal audit service is provided in-house, the audit committee chair should be consulted on the annual performance appraisal of the head of internal audit. This appraisal process is the responsibility of management.

Removal or resignation of auditors

72. Subject to normal staffing arrangements (for ‘in-house’ auditors) and any contractual arrangements in place, only the governing body (or the audit committee where delegated authority exists) may pass a resolution to remove the internal auditors before the end of their term of office if serious shortcomings are identified.

73. Where internal auditors cease to hold office for any reason, they should provide the governing body with either a statement of any circumstances connected with their removal which they consider should be brought to the governing body’s attention, or a statement that there are no such circumstances. The internal auditors may also request an extraordinary general meeting of the governing body to consider the statement. Any such statements should also be sent to the HEFCE assurance service by the HEI – or, if it fails to do so, by the outgoing internal auditors.

74. The governing body must inform HEFCE’s assurance service without delay of the removal or resignation of the internal auditors and of the reasons.

Restriction of auditors’ liability

75. Where the internal audit service is provided through a contractual arrangement with an external provider, the provider may ask the HEI to agree to a restriction in the auditors’ liability arising from any default by the auditors. Normally such liability should be without limit. However, HEIs may negotiate a restriction in liability so long as the decision is made on an informed basis. The governing body, through the audit committee, should be specifically notified of any request for a liability restriction.

Fraud and corruption

76. The work of the internal audit service, in reviewing the adequacy and effectiveness of the internal control system, should help management to prevent and detect fraud. The internal audit service should ensure that it has the right to review, appraise and report on the extent to which assets and interests are safeguarded from fraud. When internal auditors suspect fraud, or are carrying out a fraud investigation, it is important to safeguard evidence. They should assess the extent of complicity to minimise the risk of information being provided to those involved, and the risk of misleading information being obtained from them.

77. The HEI should ensure that the internal auditor is informed, as soon as possible, of all attempted, suspected or actual fraud or irregularity. The internal auditor should consider any implications in relation to the internal control system, and make recommendations to management, as appropriate, to strengthen the systems and controls.

Relationship with other auditors

78. There should be regular liaison between internal auditors and the HEI's external auditors to optimise the service provided to the HEI. External auditors should be given access to the internal audit service's working papers and plans so that their work programmes can be adjusted accordingly, and so that the extent of their reliance on the work of the internal audit service can be determined.

79. Copies of the internal audit service's reports should be available to the external auditors. The internal audit service should also receive copies of the external auditors' plans and management letters, and any other relevant reports produced for the HEI by other agencies. The HEFCE assurance service must be allowed access to any work of the internal auditor, including the annual report, or correspondence between the internal and external auditors.

External audit arrangements in HEIs

Introduction

80. External auditors in the sector are expected to follow the Statement of Recommended Practice: accounting for further and higher education (SORP) and the accounts direction published as a circular letter every year by HEFCE (the most recent one was HEFCE Circular Letter 22/2007).

Role of external auditors

81. The primary role of external auditors is to report on the financial statements of HEIs, and to carry out whatever examination of the statements and underlying records and control systems is necessary to reach their opinion on the statements. Their report should also state whether, in all material respects, recurrent and specific grants from HEFCE (and other bodies and restricted funds where appropriate) have been properly applied for the purposes provided, and in accordance with the institution's Financial Memorandum with HEFCE: in other words that the conditions of grant have been met.

82. We accept that we are not the direct client of the external auditor and that the auditor does not have a duty of care to us. However, we require that external audit engagements in the sector meet the requirements of this Code.

Qualification of external auditors

83. The qualifications required for external auditors of higher education corporations are set out in paragraph 59(b) of Schedule 8 of the Further and Higher Education Act 1992. For other HEIs, the requirements are the same as under the Companies Acts.

Auditors should be registered with one of the appropriate professional bodies, and conform to that body's standards.

Selection criteria and procedures

84. The governing body is responsible for appointing external auditors, although it will usually delegate the detail of the process to the audit committee. Before receiving proposals, the HEI should determine selection criteria, procedures and the frequency of external testing.

85. The duties of HEIs and external auditors should be clearly presented in the agreed terms of reference. A model external auditors' letter of engagement is available from the HEFCE assurance service.

Additional services

86. HEIs may ask external auditors to provide services beyond the scope of the audit of financial statements, including special investigation work, taxation compliance and advice, consultancy and VFM reviews. Generally, it is a matter for HEIs and auditors to agree precise requirements, although the audit committee must be informed of all significant facts and matters that have a bearing on the auditors' objectivity and independence, related to the provision of non-audit services, including the safeguards put in place. Any additional work must not impair the independence of the audit function, and so should normally be the responsibility of different staff within the firm of auditors.

87. The audit committee has a key role to play where the auditors supply a substantial amount of non-audit services. The committee must keep the nature and extent of such services under review, seeking to balance independence and objectivity with the HEI's needs.

88. In order to help judge the relationship between the HEI and its external auditors, the HEI must disclose separately, by way of a note to its financial statements, the fees paid to its external auditors for other services. Each HEI's audit committee must review both the level of fees incurred and the future planned work, and satisfy itself that the extent and nature of other work does not affect the objectivity of the external audit.

Management letter

89. External audit should report to the institution by way of a management letter which highlights any significant accounting and control issues arising from the audit. The HEI's management should provide written responses to any recommendations made or issues raised. The Code is not prescriptive about the format or title of a management letter, but it should enable the HEFCE assurance service to see what observations have been made about the internal control system and how management has responded.

90. External audit should also indicate in the letter whether, or to what extent, it is content to rely on the work of the internal auditors in support of external audit work. These statements will be based on work which should already be carried out for the

purpose of external audit. They provide information which is useful to the audit committee and to us in determining institutional risk assessments.

91. The letter, with management responses, should be made available (in draft if necessary) to the HEI's audit committee in time to inform the committee's annual report, and in any event no later than two months after issuing an opinion on the financial statements. HEIs must send a copy of the final management letter (incorporating management responses) to the HEFCE assurance service according to the timetable published annually in a circular letter. External auditors should attend audit committee and/or finance committee meetings at which the audited financial statements are discussed, and attend governing body and other meetings when appropriate.

Audit report

92. The external auditors shall report whether in all material respects:

a. The financial statements give a true and fair view of the state of the HEI's affairs, and of its income and expenditure, recognised gains and losses, and statement of cashflow for the year. They should take into account relevant statutory and other mandatory disclosure and accounting requirements, and HEFCE requirements. The financial statements comply where appropriate with the Statement of Recommended Practice (SORP) on Accounting in Further & Higher Education, and the Companies Acts (where the HEI is incorporated under the Companies Act), and/or other legislative or regulatory requirements.

b. Funds from whatever source administered by the institution for specific purposes have been properly applied to those purposes and, if relevant, managed in accordance with relevant legislation.

c. Funds provided by HEFCE have been applied in accordance with the Financial Memorandum and any other terms and conditions attached to them. In particular, auditors should have regard to the specific requirements of the Financial Memorandum, such as compliance with the short-term and long-term borrowing conditions.

93. HEFCE publishes as a circular letter an annual accounts direction (see paragraph 80) and institutions and their external auditors are required to conform to it. The accounts direction summarises and updates HEFCE's financial reporting requirements.

94. External auditors have a duty to consider the statement of internal control with the annual financial statements and to comment if the statement is inconsistent with their knowledge of the HEI. It is for each HEI to decide whether it wishes its external auditors to do more than this required minimum. Each HEI needs to ensure that processes are in place – including work by internal auditors, external auditors and management – to provide assurance on the effectiveness of the arrangements underpinning the statement of internal control. External auditors may report privately to the governing body (through the audit committee) on the results of their work on this, or may make reference to this in the financial statements, either in their audit opinion report or through a separate report.

Reappointment of external auditors

95. HEIs should reappoint external auditors formally each year. The audit committee should assess the auditors' work each year to ensure that it is of a sufficiently high standard and represents value for money. The committee should then make a recommendation to the governing body regarding the reappointment of the auditors. Performance measures could be used as part of the assessment. Provided that the auditors' performance is satisfactory, it will not be necessary to repeat the full selection process each year. However, full market testing should be undertaken at least every seven years. One partner in the firm is normally responsible for the institution's audit; he or she should not hold this position for more than seven continuous years.

Removal or resignation of auditors

96. The governing body may pass a resolution to remove the auditors before the end of their term of office if serious shortcomings are identified.

97. External auditors who have resigned or been removed from office for whatever reason should be entitled to attend, and make representations to, the general meeting of the governing body at which their term of office would have expired, or at which it is proposed to fill the vacancy caused by the resignation or removal. They are entitled to receive notices of, or other communications relating to, that meeting, and to be heard on any part of the business which concerns them as former auditors of the HEI.

98. As with internal auditors the governing body is responsible for advising HEFCE where external auditors cease to hold office and the reasons for this.

99. In deciding whether or not to accept the appointment, anyone proposing to take up the office of external auditor should obtain the HEI's permission to communicate with the outgoing auditors. Outgoing auditors should also obtain permission from the HEI to discuss its affairs freely with the proposed auditors, and should disclose all information required by the proposed auditors that is relevant to the appointment. These provisions are analogous to those in the Guide to Professional Ethics of the ICAEW.

Restriction of auditors' liability

100. HEIs must not agree to any restriction in external auditors' liability in respect of the external audit of their annual financial statements, unless a liability limitation agreement has been entered into under the terms of the Companies Act 2006 and the Limited Liability Partnerships Act 2000.

101. For other types of work performed by the external auditors, the provider may ask the HEI to agree to a restriction in the auditors' liability arising from any default by the auditors. Normally, such liability should be without limit. However, HEIs may negotiate a restriction in liability so long as the decision is made on an informed basis. The governing body, through the audit committee, should be notified of any liability restriction agreed.

HEFCE access to external auditors

102. The HEFCE assurance service may wish to meet with HEIs' external auditors, particularly in connection with a visit to the HEI. The HEI should not limit access in any way. Formal discussion should normally be arranged through the HEI's designated officer or representative. The HEFCE assurance service will exchange letters where necessary with both parties to deal with confidentiality and the terms under which access is given.

Appendix to Annex B
Guidance on value for money (VFM) strategies and reporting

This guidance proposes that institutions already have, or should have, the information necessary to demonstrate their overall effectiveness and thus that they are achieving value for money. At the end are examples of a VFM strategy and annual report.

Introduction

1 This guidance on value for money (VFM), a component of the 2008 HEFCE Audit Code, replaces the previous guidance and provides a new perspective on value for money. This new perspective stresses that for value for money to be achieved an institution needs to be as effective as it can be in its use of public money.

2 The guidance has been produced in response to calls, particularly from audit committees and internal auditors, for help in pursuing VFM. It has been prepared with help from audit practitioners and audit committees.

Current approach to VFM

3 The VFM activities that have typically been overseen by audit committees across the sector have in the main been 'stand alone' activities to the rest of the institution's operations. A typical approach to date will have included:

- existence of the VFM working/steering group
- tendering and quotation requirements within the financial regulations
- a programme of tendering for key services (such as energy suppliers, banking, photocopiers) and a procurement team to support this work
- the establishment of framework agreements for professional services (for example, estates)
- internal reviews on a periodic basis of particular departments, areas of activity
- VFM reviews (catering, security, procurement and others)
- internal audit's feedback on the efficiency, effectiveness and economy of the systems and processes it has reviewed
- outcomes of benchmarking exercises that have been undertaken either with other peer institution or cross-sector benchmarking, such as that facilitated by HESA or HEFCE.

4 VFM reviews like those above are tools: they provide a level of critique and challenge to the subject chosen to identify scope for improvement. However, in the context of the current HE environment where there is an explicit need to become more financially sustainable, as well as remain attractive to potential students, researchers, and businesses, there is a question of whether these reviews have been in the right areas in order to support the institution in meeting its key challenges.

5 Of late there has been debate in some audit committees around establishing what other activities are undertaken that actually improve VFM, but which the committee is not aware of formally.

6 Listed below are a number of activities that are likely to form part of the routine management practice within the institution and which could give a broader appreciation of institutional effectiveness than the possible piecemeal approach in the examples in paragraph 3, such as market testing and benchmarking of service provision:

- strategic planning process
- key performance indicator (KPI) systems and/or corporate dashboards
- financial strategy and the budget setting/cost reduction process
- costing and pricing policies (TRAC and full economic costing)
- National Student Survey
- risk management
- course costing and portfolio reviews
- business process reviews and systems development
- performance appraisals and career development
- purchasing activities
- programme quality processes
- HEFCE initiatives, such as Rewarding and Developing Staff
- discrete reviews, for example retention, student experience.

7 Every activity above will have an objective and a desired outcome, and recommendations that the institution will have actioned as a result. However, they are not always at present reported through to the audit committee as contributing to the VFM agenda of the institution. It can be the case that these activities are reported to some other committee or process of the institution and, even in summary, the audit committee may not be aware of them. As a result there is not a single point in an institution where all VFM related activities and their effectiveness can be considered.

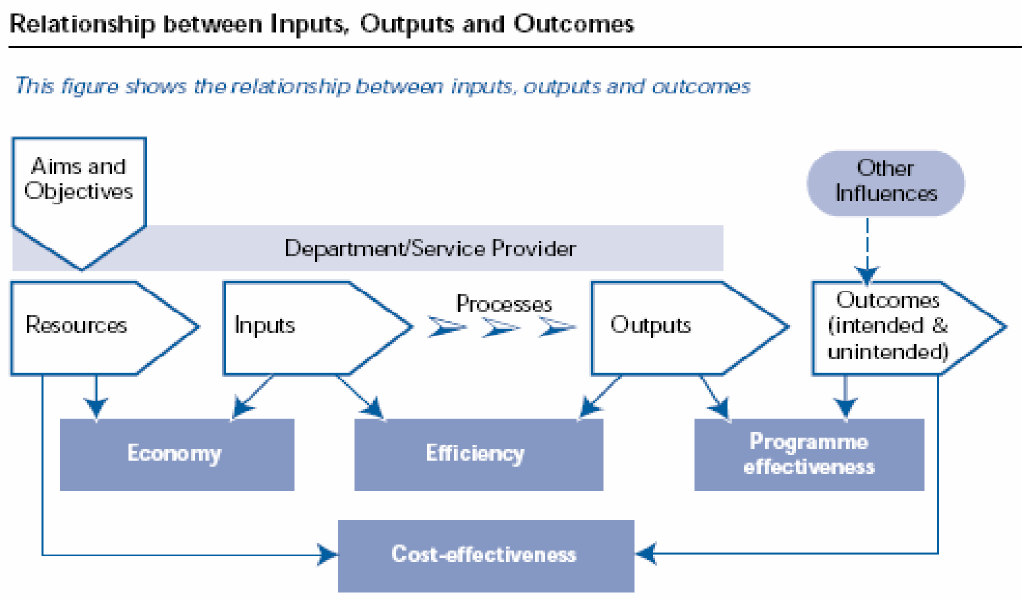
8 To enhance the focus and interpretation of VFM by the institution as a whole and of the audit committee, we believe that it may be appropriate for the committee to become more aware of these activities and factor them into how they fulfil their responsibilities. We accept that institutions will want to do this in such a way that it does not duplicate reporting and create work unnecessarily.

9 Figure 1 more clearly defines value for money and how it relates to all activities that are undertaken by an institution.

10 The activities listed in paragraph 6 are all facets of performance. We suggest that information which reflects an institution’s performance is information that already reflects the achievement of VFM. Some institutions will have an explicit performance management system. Effective performance management should integrate planning, review, financial management and improvement systems to enable management and members to make informed decisions for the improvement of services.

11 An explicit performance management approach can provide a new perspective on VFM by institutions. In some institutions the adoption of such an approach might reveal that readily available data already exists to demonstrate VFM.

Figure 1 Defining value for money



12 The objective of a VFM strategy is to provide a guide to staff and members on how to secure and measure institutional effectiveness. Over time, as VFM becomes more embedded in the routine management culture of the institution, the importance of a VFM strategy may diminish. The VFM strategy should be considered, approved and supported by the HEI's senior management team (SMT), the audit committee and the governing body.

Sample value for money strategy and annual report

13 We suggest the following format for a potential VFM strategy, although each institution will wish to adopt an approach suited to its own needs.

14 This VFM guidance has been produced at the request of institutional representatives. It underlines HEFCE view that VFM is inextricably linked with institutional performance. The model strategy and annual report below are for those institutions who feel they need examples to take into account. HEFCE will not be looking for compliance with these models.

15 This guidance was produced by HEFCE working with KPMG, UNIAC, Kingston Audit Consortium and the Audit Committee Development Group.

Sample value for money strategy

Context

ABC University has a challenging strategic plan. This seeks to further grow student numbers in both undergraduate, postgraduate, full and part time, both home/EU and overseas. Alongside this we are aiming to build upon our renowned reputation for working with business in order to increase the income streams from this and our research activity.

Our ambition is made more challenging by the changing face of the higher education market. The higher education market is becoming more competitive. Students, while always key stakeholders, are now asking more of us in return for the increased investment that they are making in the institution. Businesses are looking to engage with institutions that are the best in their respective field. Therefore we need to have the staff, skills, structures and systems that enable us to change and continually improve our performance to meet these evolving needs. The value for money (VFM) agenda is a key enabler in helping the institution fulfil its ambitions as it seeks to continually appraise and challenge not only our performance but also our working practices. The institution has therefore positioned the value for money strategy alongside the other 'enabling strategies' within the corporate planning framework.

Principles of VFM

The simple principle that is applied to all of our work is 'to make the best use of the resources we have available in order to achieve the desired output and maximise the benefit achieved from that output'.

Objectives of ABC University VFM strategy

1. To appraise the institution's operational effectiveness and increase the efficiency and effectiveness of our systems and processes that seek to fulfil the corporate plan.
2. To embed the pursuit of increased efficiency and effectiveness while maintaining costs to affordable levels throughout all layers of management in the institution.
3. To challenge current practices and approaches in order to improve performance and position the institution to meet future challenges.
4. To apply the lessons learned from investigations and reviews in certain areas, to other areas in order to maximise the benefit of this work.

The VFM activities that will ensue from this strategy seek to enable the institution to achieve competitive advantage by performing in a way that makes the best use of the resources available. Specific benefits will be determined for each discrete VFM activity undertaken to provide a basis for determining the benefit achieved from such activities.

Responsibilities

Responsibility for pursuing value for money is shared by all staff and governors.

In the formal sense of responsibility the governing body is required by the Financial Memorandum between the institution and HEFCE to:

- deliver value for money from public funds
- review the arrangements for managing the resources under its control.

The audit committee is required to fulfil its obligations under HEFCE's audit code of practice (Accountability and Audit: HEFCE Code of Practice) by receiving assurance that satisfactory arrangements are in place to promote economy, efficiency and effectiveness. However given the importance of the VFM strategy to the continued development of the university, the governing body has delegated responsibility to the committee for monitoring progress against the performance improvement plan. This involves receiving update reports throughout the year from management together with the outputs achieved.

The vice-chancellor and his/her management team are responsible for developing and implementing the VFM strategy as part of their performance management arrangements.

The senior management team (SMT) [or possibly a dedicated performance monitoring/VFM group] will have operational responsibility for developing the performance improvement and VFM arrangements and identifying resource requirements, co-ordinating and delivering work against this plan.

Approach

We will seek to achieve continuous improvement in the following ways:

- continually assess our performance against the agreed performance indicators both at senior management team and governing body levels
- introduce performance improvement targets into the personal objectives of the senior management team, deans and directors. The institution's appraisal process will then enable progress against these targets to be monitored
- benchmark our own performance against our performance indicators externally, and internally by breaking these down to academic and service function level
- investigate areas where the benchmarks suggest that we are underperforming or underachieving to establish how we can revise our practices and approaches to improve our performance
- introduce an incentive scheme for staff to make suggestions for innovative ideas that will improve the performance of the institution
- undertake process improvement reviews in areas that have been assessed by management as falling short in terms of the benefit they are providing to the institution either currently, or into the future
- provide training and development opportunities in VFM thinking and appraisal techniques for managers.

Our approach will be informed by relevant internal and external data from a wide range of sources including the Higher Education Information Database for Institutions (HEIDI).

Reporting

The SMT will arrange for an annual update publication for staff on the successes and benefits arising from the VFM work and performance improvement plan.

The audit committee will receive a progress report at each of its meetings to enable progress against the performance improvement plan to be monitored. The committee will also receive details of the institution's performance using the performance assessment framework on an annual basis. This will be at the same time as receiving the performance improvement plan for approval.

Any findings and recommendations arising from VFM activities will be fed into the annual operating review, through the SMT. Progress against all actions arising from VFM activities will be tracked through to resolution by the SMT.

The University will produce an annual VFM report each year which will be adopted by the governing body on the advice of the audit committee. Our report for the past year can be found below.

Sample annual report: ABC University VFM report for 200x/yy

Introduction

ABC University has a clear strategic vision in that it aims to increase understanding and share knowledge for the benefit of its students and local businesses. In this context the University aimed to embrace the spirit of VFM and sought to adopt a process of continuous appraisal and challenge by all managers across the institution.

The SMT, along with the support of the finance and audit committees, adopted an approach to VFM/performance enhancement whereby as far as possible managers would be encouraged to critically appraise their own operations (processes, approaches, etc) in order to improve the level of service that is received by students and local businesses. The SMT clearly set an expectation that such reviews should not focus on ‘cutting cost’ alone, and stressed that improved performance can be one or a combination of improved efficiency, effectiveness or reduced cost.

Alongside the move to embed the concept of performance enhancement at a school/departmental level, the SMT collectively considered key processes across the University and whether these were fit for purpose currently and whether this would continue to be so for the next five years, given the changing focus of the University and that of the HE landscape more generally. From this several projects were identified for further work and investigation over the next two to three years.

Key processes and achievements during the year

- *Achieving business and operational plans* – One of the most important aspects of performable improvement is the achievement of the business and operating plans for the current year. We set some ambitious financial targets which required the operational plans of the schools and departments to become more innovative, inclusive and focused on the primary goals of the University. We are pleased to report that the University has achieved these plans for the current year and we are entering 200x/yy in an improved position.
- *Key performance indicators* – the University has embraced the new CUC guidance on key performance indicators, and has introduced a small number of KPIs for use by governors. Performance is reported against these KPIs (where appropriate) to every other meeting of the governing body, and we have recently completed an annual report that details our performance against every indicator. As a management group we have appraised the benefits of having these KPIs and are now committed to

introducing a KPI model at a lower level in the University. This will be used to provide a high level overview of the performance of each department and school, and will be used by members of the senior management team. The indicators will be designed such that they enable in-year monitoring (i.e. the availability of data enables in-year measurement).

- *National Student Survey* – Given the focus that this University has on its students, the improvement in our score in the National Student Survey is a tremendous result and a credit to all of our staff that have contributed to the experience of ABC University students. The results have however highlighted pockets of the University that could do better, as well as some themes for improvement. Both are being taken forward by management to ensure that we continue to improve in these areas.
- *Commercial and third party activity* – The University has had a specific aim to increase its level of interaction with local businesses in order to adapt our activities to meet the needs of the local business community. During the year we are pleased to report a 45% increase in the number of contacts that the University has with local businesses, as measured via the business link database. There has also been a 15% increase in the level of income from local businesses as a result of applied research and the provision of CPD activity.

Roles and responsibilities

ABC University has been clear that the pursuit of performance improvement must not be a stand alone activity. For this reason we have adopted some new principles and begun to embed these at various levels across the University. Below is a summary of the key roles and responsibilities that have contributed to the improvement in the University's performance during the year:

- The governing body has ultimate responsibility for the performance and development of the University. Therefore in addition to the routine updating and reporting we have introduced a number of high level performance indicators that have been reported three times during the year.
- The SMT is responsible for ensuring that the expectations of the governing body members are fulfilled. This is achieved through each member of SMT effectively managing and monitoring the performance of their respective areas. During the last year the role of SMT members has also been to encourage and embed a mindset that is focused on performance improvement. As this has been the first year, this has constituted the promotion of thinking differently and questioning existing practices with a view to achieving efficiencies and increasing the effectiveness of the key processes across the University. SMT has also collectively debated the suitability of a number of key processes across the University, including the international office, initiative and project management and student administration.
- In fulfilling their responsibilities the audit committee members have maintained an overview and awareness of the processes that have operated during the year in respect of performance improvement and VFM. SMT presented a paper to the committee outlining the plans for enhancing performance, and this included specific activities that would take place in the year. It was agreed with the committee that, further to setting out this plan, an annual summary would be provided of the key achievements and benefits derived from this work. However, if actions slip in terms of

the planned activities and/or if there is a substantial change to the approach, a further update would be provided to the committee. We are pleased to report that there were no changes to the approach during the year.

- Through the annual planning process Deans and Directors have been empowered to consider on a continual basis options for enhancing performance. However, in contrast to previous years, there has been an emphasis placed on encouraging them to use their networks with other institutions to learn how other institutions undertake activities and provide services, and the impact that this has on the students and staff. This is with a view to identifying options for enhancing the processes that operate within their areas of ABC University.

Initiatives and discrete activities

Following on from the structural emphasis that has been placed on performance improvement, a number of discrete activities have taken place during the year. These have provided a basis from which our performance can be enhanced, and are summarised below:

Activity	Benefit
Benchmarking of support costs – The director of finance engaged a third party to benchmark the support costs and constituent parts of the University and compare these to a peer group of similar universities in the sector.	A tangible and informed basis has been provided from which decisions can be made and priorities determined for the further investigation of some apparent outlying results. The benchmarking also provided some assurance that there are very few areas where the University is out of line in terms of support costs with the peer institutions.
Revised international strategy – The University has restructured the international office and a new international strategy has been produced. At the same time the approaches to student recruitment, application, retention, general support and the use of agents has been revised.	The benefits from the work undertaken in the year will not be realised in full until the end of the next year when a full cycle of international activity and the student journey is complete. We can however report an 18% increase in the number of overseas student applications, but the agency costs have reduced as a result of using fewer more effective agents.
One stop shop – The University has completed the development of a ‘one stop shop’. This will provide a single point of contact for students and the University support functions (finance, registry, student support etc)	The benefit of this new development will be an enhanced student experience, but the actual benefit achieved will not be quantifiable until the end of the coming year.

We can also confirm that the following activities have continued to operate during the year, each of which contributes to furthering the VFM that is achieved by the University:

- 21 tendering exercises have been undertaken for a variety of services

- the University's key supplier listing has been rationalised as a result of the tendering exercises above, and more advantageous arrangements have been established for utilities and computers
- the proportion of full economic cost achieved from commercial activity has increased by 8%
- a tool has been developed to appraise the financial feasibility of academic programmes
- the course portfolio has been rationalised such that courses will no longer run where there is insufficient demand
- staff costs as a proportion of turnover have been maintained at prior year levels (64%).

Next year's priorities

We do not propose any significant changes for the coming year to the structure that has been established to promote performance improvement and VFM. However, as a result of the work undertaken during the year, the following activities have been identified to be undertaken in the coming year, together with any other priorities that emerge from the work of the senior management team:

- refinement of KPIs for use at school and department level
- implementation of a University project management methodology
- enhancement of the personal development process to incorporate specific aims in respect of VFM improvement.

Consultation questions on the Accountability and Audit Code of Practice

Question 7: Do you agree that the Code should endorse practice guidance from CUC, on audit committee operations, and from the IIA, on internal audit, rather than HEFCE giving its own detailed guidance?

Question 8: Is the new mandatory requirement for audit committees and internal auditors to provide opinions on data quality appropriate?

Question 9: Do you agree that where internal audit is provided in-house, the nature of the provision should be subject to periodic reconsideration?

Question 10: Do you agree that the decision about whether there should be minimal cross-representation between audit and finance committees should be for the governing body rather than HEFCE to make?

Question 11: Is the new guidance on value for money helpful?

Annex C
Allocating and paying funds

1. Each year we determine how much money to allocate to each institution. In doing so we may distinguish between recurrent and capital funds; and between formula capital and project capital.

2. HEIs should use this money only for the proper purposes, as defined in the 1992 Act. The same conditions apply if they pass on the money to another body or organisation to provide education, research or related activities.

3. The HEI remains responsible for overseeing such activities. There should be a written agreement with the other body covering financial accountability and quality assurance. However, this is not necessary if the other body is an HEI, or HEFCE agrees to the arrangement.

4. Sometimes we pay funds to an HEI or FEC as the lead institution for a consortium of universities and colleges. In such cases, there should be a consortium agreement setting out how the money is passed on to the consortium members. Guiding principles for agreements are published in HEFCE 00/54.

5. An institution must use specific or capital funding for those purposes only. If it uses them for other purposes, it must let us know as soon as it becomes aware of the fact.

6. We will tell institutions their allocation of formula funds as soon as we can – normally by 31 March – in advance of the academic year to which they relate. We will usually pay such funds in monthly instalments. The profile of payments will take into account the expected needs of the sector as a whole and the receipt of tuition fees from students and the Student Loans Company.

7. We will pay formula funding for widening access and improving retention only where institutions have sent us widening participation strategies and action plans that we find acceptable.

8. We will consider requests from individual institutions to alter the profile of payments, provided that such payments are not in advance of the institution's need to spend the money.

9. Our capital grants will in future be administered through our capital investment framework. Institutions that meet the framework requirements will have discretion over the use of capital funds in line with their estates' strategies. We will continue to require other institutions to send us details of capital programmes and projects to which we may contribute costs, in line with criteria we set. We will set out conditions for such grants and agree a payment profile with the institution. All institutions are expected to work towards satisfying the requirements of the capital investment framework.

10. We may require an institution to repay part or all of a grant payment if it does not comply with the conditions we attach to the grant. We may reduce or withdraw funding from an HEI or FEC that fails an audit re-inspection by the QAA. In these cases we may require the institution to pay interest, at 2 per cent above the Bank of England base rate, for the period before it repays the funding to us.

11. If we overpay grant as a result of using estimated data, we may recover the amount overpaid amount, plus interest, as set out in the previous paragraph.

Annex D
Institutional engagement and support strategy

Introduction

1. This strategy sets out how we will engage with and support HEIs and our related bodies (RBs) on matters relating to performance, accountability and risk assessment. It also describes what will happen when as a result of our assessment we find there to be significant risks, either to the organisation itself or to HEFCE's functions or interests.

2. The principles underlying our institutional engagement and support strategy are that we will:

   a. Respect the independence of HEIs and the formal status of each related body: the operation of our engagement and support strategy underwrites the independence of institutions when they are not at higher risk.
   b. Maintain an open dialogue on matters of mutual interest.
   c. Seek to intervene only when necessary.
   d. Be open with the institution or RB in our risk assessment and requirements.
   e. Ensure our involvement is proportionate to the risks.
   f. End our involvement as soon as possible.

3. In broad terms there are three levels at which HEFCE may engage with institutions:

- normal contact (in all cases)
- focused dialogue (in some cases)
- HEFCE's support strategy (exceptionally).

Normal contact

4. As part of our routine engagement with institutions and RBs we will want to understand their mission, strategy and operational plans. This will help us to make appropriate responses to their – and the sector's – needs, and to gain assurance about matters that affect the delivery of our own objectives. There will often be a formal visit by the HEFCE regional team to the institution in each year, and in the context of a more frequent exchange of information and views. It is also part of our normal contact to discuss an institution's accountability returns and give feedback, as part of the single conversation process.

Focused dialogue

5. There are occasions when it is to the advantage of both HEFCE and institutions to explore issues in more detail. For example, an institution may wish to make a bid to our Strategic Development Fund, and we will want to understand how such financial support might meet its development needs and fit with our wider objectives for the sector. Likewise, we may wish to discuss with an institution whether there are opportunities to improve its performance or work collaboratively with others. We emphasise that we wish to work with the sector and are not assuming a planning role.

Support strategy

6. We have a risk assessment system covering all institutions and RBs. This draws on the information we routinely collect through the single conversation process, and on other information such as research and teaching quality assessments. Sometimes we will ask for more information to clarify our understanding. There are currently two risk categories: 'not at higher risk' (the vast majority of the sector at any time) and 'at higher risk' (for a small number of institutions).

7. Through these annual returns or our regular contact with an institution or RB, there may be issues that require further discussion. All institutions face business and operating risks. The issue is therefore about managing risk: putting in place systems to identify, mitigate and report on risk. In many cases, as a result of further discussions, we will conclude quickly there is no cause for concern.

8. We will consider an institution or RB to be potentially at higher risk if there remain significant concerns in one or more of the following areas:

- financial position or prospects
- student recruitment
- reliability or use made of the institution's systems of financial control
- assessments of teaching or research quality
- rates of student non-continuation and/or non-completion
- management and governance processes
- risk management
- management and sustainability of the organisation's infrastructure
- overall market position and strategic direction
- non-compliance with the Financial Memorandum – including the requirements to use funds for the purposes intended and to meet the annual Accounts Direction.

9. When we have major concerns we need to intervene to protect the public interest. We will firstly discuss these issues with senior management, and specifically the designated officer (of an HEI) or chief executive (of an RB). We will seek a common understanding of the issues, clarify what actions have already been taken or are planned, and then agree an appropriate support strategy. Table 1 sets out the range of possible actions, though sometimes we will agree a different approach with an HEI or RB.

10. The director responsible for dealings with the HEI or RB will lead our support activity, but a relevant senior manager – the HEFCE regional consultant, relationship manager (in the case of an RB) or assurance consultant – will manage the day-to-day engagement. In exceptional cases, our chief executive will become involved. All cases will be overseen by our audit committee and reported to the HEFCE Board.

11. If an institution or RB fails to address its problems, it might be in the public interest for us to disclose our risk assessment. We expect this to be a very rare occurrence, because in our experience institutions generally do take appropriate action.

Table 1: HEFCE support strategy for HEIs and related bodies ‘at higher risk’

Possible HEFCE actions	Likely frequency
At governor and senior manager level	
Engage with senior management, including the designated officer	In all cases
Assess the designated officer’s compliance with the Financial Memorandum	Consider in the light of management response
Inform the governing body of our change in risk assessment	In all cases
Engage with the chair of the board and/or chair of the audit committee	Where this might assist timely and appropriate by the institution
Engage with the whole governing body	Exceptionally
Seek observer status at governing body or audit committee meetings	Exceptionally: if risks threaten viability, or if we lack confidence in the response
Request the appointment of interim managers, or secondments from HEFCE	If management capacity needs to be strengthened to mitigate risks to HEFCE’s interests, or where viability is threatened
Regarding information and audit	
Require additional information, reports and data relating to the risks	In all cases
Require that information and reports be audited	If information has proved to be inadequate or unreliable
Request changes to internal or external audit arrangements	If audit work has failed to identify major risks
Undertake or commission audit investigations	Where we need an independent assessment of risks and action plans
Regarding planning and strategy	
Require a recovery or action plan	In all cases
Discuss possible changes to strategic plans and market positioning	If there are risks associated with the strategy or market position
Explore collaborative opportunities with other institutions	If the risks might be mitigated through collaboration
Regarding funding	
Re-profile grant	If cash-flow or liquidity are major

	concerns
Consider the use of special funding	If additional funding might mitigate risks, and if the plan meets HEFCE’s funding objectives
Attach special conditions to grant	If this will promote action or prevent inappropriate action
Reduce or withdraw funding	Only in extreme circumstances, and then proportionately
As risks decline	
Inform the institution about changes in our risk assessment	In all cases
Remove special conditions and requirements	Where appropriate

Annex E
Annual assurance return from institutions

This return is to be submitted as part of the single conversation return, the timetable for which will be specified annually in a circular letter. The purpose of the return is to confirm that the institution has met its obligations to HEFCE under the Financial Memorandum. The return should be signed by the designated officer and should be copied to the institution's governing body.

Institution	…………………………………………
Year ended	…………………………………………
Return completed by designated officer (enter name of head of institution)	…………………………………………
Have you submitted the audit and other returns to HEFCE as part of the 'single conversation' checklist and were these returns considered by the governing body?	
Have there been any changes of senior officer in the period which have not been notified to HEFCE, including the chairs of the governing body and audit committee, the designated officer and the heads of finance and internal audit?	
Who is the external audit provider? Has there been a change of provider in the year? If so, why?	
If your internal audit is provided under contract, who is the provider? Has there been a change of provider in the year? If so, why?	
If your internal audit is provided in-house, has there been a change of head of internal audit in the period? If so, why?	

When did you last complete a review of governance effectiveness and institutional performance as recommended in the CUC Guide for Members of Governing Bodies?	
Has there been any confirmed instance of serious weakness, such as fraud, that should have been notified as required under the HEFCE Code of Practice. If so, please provide details.	

Signed ……………………………………………..

Dated ………………………………………………

Annex F
Consent for financial commitments

Introduction

1. An institution must get written consent from us before it agrees to any new financial commitments as follows:

   a. Long-term commitments – where the annualised servicing cost (ASC) of its total financial commitments would increase to above 4 per cent of total income.
   b. Short-term financial commitments – where negative net cash exceeds 5 per cent of total income for more than 35 consecutive days.

Definitions

Total income

2. Total income is as reported in the latest audited financial statements, or the estimated amount for the current year if that is lower.

Short-term commitments

3. ‘Negative net cash’ is determined on a cash book basis and as defined by FRS 1 (revised 1996): ‘Cash Flow Statements’.

Long-term commitments

4. The requirements of paragraph 19 of the FM only apply when an institution intends to:

- take out additional financial commitments, including repayable grants from us, or
- refinance existing financial commitments, including fixing the interest rate.

5. There is no need to seek our consent where the ASC increases above the 4 per cent threshold, or any other threshold approved by the Council, solely as a result of either an increase in the interest rate on variable rate borrowings or a reduction in total income. Similarly, consent is not required if refinancing existing commitments results in a lower ASC.

6. In all cases, the ASC calculation should reflect the economic substance, which may differ from the legal form.

7. Long-term financial commitments mean amounts which are due for payment after more than 12 months, in accordance with Generally Accepted Accounting Practice (GAAP). These include:

- all borrowing, whether self-financing or not
- finance leases, subject to the exclusion below
- inherited debt and leases which are not fully reimbursed by us
- PFI arrangements which are accounted for as loans or finance leases in accordance with the requirements of SSAP 21 or FRS 5.

And exclude:

- lease payments where the combined ASC of such leases does not exceed 0.5 per cent of total income.

8. The annualised servicing cost of the financial commitments consists of total expected net cash payments (capital and interest) over the period of the loan, divided by the loan period in years. This includes lump sums at the end of the term.

9. Where the financing involves a lease-and-leaseback of existing assets (that is, the institution receives rental income linked to rental expenditure), the ASC should be calculated on the net cash outflow.

10. For new loans, the interest rate to be used in the calculation is the one in force at the start of the loan, whether this is fixed (for all or part of the loan period) or variable. For existing loans, the interest rate to be used is the one currently in force.

11. The loan period is as defined at the time when the commitments are agreed. It starts when the first part of the loan is drawn-down and ends when the final liability is repaid. If there is an option to extend at a later date any part of the commitments to a longer term, the ASC will still be measured on the original term.

12. Where the loan period is to be shortened or extended, the ASC calculation should be reworked using the revised term and rates of interest in force at that time. If this increases the ASC above the 4 per cent threshold, the institution must get (revised) written consent from the Council.

Our response

13. The Council will try to give a response to a request for consent within 15 working days of the receipt of all relevant information. Where the proposed ASC for long-term financial commitments is above 7 per cent, approval must come from the HEFCE Board. This will extend the period required to deal with the request, and institutions should discuss this with us when they are planning to seek consent. We accept, however, that very occasionally an institution may need to get a faster response, in which case it should discuss this with us at an early stage in developing its plans.

14. In responding to requests for consent we aim to be helpful and pragmatic, applying the general principles outlined here to the circumstances of each proposal. If an institution is unsure how to calculate the ASC or whether consent is required, it should discuss this with us.

Information required

15. We set out below the information we require to consider a request for consent. This addresses the issues we would expect the institution’s own governing body to seek assurance on before approving additional financial commitments. The main focus is on affordability and risk, not necessarily on the individual project.

Long-term financial commitments
1 There should be a reasonable case for the new investment. Information required: a. Brief description of the new investment. b. An explanation of it broadly fits with the institution's mission and strategic priorities. c. Confirmation that the institution has followed HEFCE guidance on appraising investment decisions.
2 The new financial commitment or refinancing arrangement should be consistent with the institution's financial strategy and represent good value for money. Information required: a. An explanation of why additional finance or refinancing is necessary and how this fits with the financial strategy. b. The forms of finance considered and the selection process and criteria. c. The net present value (NPV) for each financing option and a brief explanation of why the chosen method was selected.
3 Details of the new financial commitments. a. Details of the chosen option, including: name of lender, sum borrowed, loan period, and basis of repayment. b. Terms and conditions of the financing (for example, a copy of the offer letter) and an evaluation of the risks and uncertainties.
4 The new investment and financial commitments must be affordable. Information required: a. An update of the latest financial forecasts, to include the impact of the new investment and financial commitments, and demonstration that they are affordable. This update must include any other material changes in the institution's financial prospects, including guarantees to third parties.
5 The institution's governing body has made an informed decision about the new investment and financial commitments. Information required: a. Details of when the governing body approved the new investment and financial commitments, and a minute of the decision reached. b. A summary of the information the governing body received in reaching its decision.
6 Details of the new threshold. Information required: a. Details of continuing financial commitments (including the lender, loan term and ASC) and of the new financial commitment. b. A calculation of the new threshold required.

Short-term financial commitments
1 Short-term financing should be an appropriate solution. Information required: a. Brief description of why increased short-term finance is necessary, and how this fits with the financial strategy. b. Cash-flow forecasts which show the need for the increased borrowing. c. The forms of finance considered and the selection process and criteria.

d. Brief explanation of why short term finance was selected.
2 Details of the new financial commitments. a. Details of the arrangement, including: name of lender, sum borrowed, loan period and basis of repayment. b. Terms and conditions of the arrangement (for example, a copy of the offer letter) and an evaluation of the risks and uncertainties.
3 The institution's governing body has made an informed decision about the short-term financing arrangements. Information required: a. Details of when the governing body approved the arrangements, and a minute of the decision reached. b. A summary of the information the governing body received in reaching its decision.
4 Details of the new threshold. Information required: a. The revised threshold (in £s) and the period for which this is required.

HEFCE guidance that may be helpful

- Financial strategy in higher education institutions (HEFCE 2002/34)
- Investment decision making: a guide to good practice (HEFCE 2003/17)
- Practical guide to PFI for higher education institutions (HEFCE 2004/11)
- Guide for Members of Higher Education Governing Bodies in the UK (HEFCE 2004/40)
- Borrowing in the higher education sector: 2004 update (HEFCE 2004/44).

Annex G
Exchequer interests

Introduction

This Annex reflects the revised system for exchequer interests which will provide better accountability for public funding while reducing the existing administrative burden upon institutions and enabling them to manage their estates more flexibly (see Circular letter 12/2006).

Requirements

1. The institution, having entered into an agreement with HEFCE effective on 1 August 2006 to enable the retrospective elements of a new system of accounting for exchequer interests to be enacted, shall follow the conditions set out below. Until this agreement is signed, the institution is bound by the pre-existing terms and conditions as set out in the pre-existing version of this model FM (HEFCE 2003/54).

2. The exchequer interest identified and agreed with HEFCE in this agreement will form the opening balance of a simple exchequer interest register maintained by HEFCE. The register will be adjusted immediately for the addition of capital grants received in the year and annually for the following:

- indexation of the opening balance and all grants received in subsequent years; and
- writing down grants over the prescribed period.

3. The indexation rate used will be the GDP deflator published by the Treasury. This will take account of changes in value and ensure that the value of the exchequer interest is not eroded through inflation.

4. All capital grants made after 1 August 2006 that create an exchequer interest will be entered onto the register, regardless of how they are treated for accounting purposes.

5. The opening exchequer interest balance as at 1 August 2006 will be written down over a 10 year period on a straight line basis. All further grants will be written down annually over 15 years from the year of the grant in question on a straight line basis, to recognise their consumption through the provision of education over that period.

6. The closing balance of the register as at 31 July 2007 and annually thereafter will provide a single reportable sum for the exchequer interest, and will be confirmed annually with the institution by HEFCE.

7. As repayment of exchequer interest is a remote event contingent upon the occurrence of what are likely to be exceptional circumstances (see below), it does not need to be disclosed as a contingent liability in the institution's annual accounts.

Circumstances in which the exchequer interest becomes repayable

8. If either of the following remote events occur, they will trigger immediate liability for the institution to repay HEFCE the full amount of the exchequer interest (as shown in the exchequer interest register at that date). The institution will recognise HEFCE as an unsecured creditor until such repayment is made. If a liability to make repayment arises, HEFCE may agree to accept repayment of some other sum, or to delay repayment, at its absolute discretion, and such agreement may be on terms and conditions as HEFCE thinks fit.

9. The first trigger event will be if the institution becomes insolvent, including going into liquidation or administration, or if it dissolves or transfers its undertaking to some other body (for example, by the exercise of the Secretary of State's powers under the Education Reform Act 1988 or otherwise), or if it experiences any analogous event.

10. The second trigger event is if there is a significant reduction in the level of HEFCE-funded activity by the institution, using the following indicators:

- the absolute level of HEFCE income
- the absolute level of total income, and
- the percentage of total income represented by HEFCE income.

11. A base level for each of these indicators will be set as at 31 July 2006 by reference to the institution's 2005-06 financial statements. The trigger event will only occur if two or more of the three indicators reduce to at least 50 per cent from the base level.

12. This second trigger has been designed to ensure that HEIs are not discouraged from generating other sources of income, providing they continue to offer the same level of HEFCE-funded education. HEIs may activate the trigger if, for example, they cease to educate publicly funded students, significantly downsize or go into liquidation, but are unlikely to do so if activities continue as normal or they expand.

13. The agreed base level for each indicator will be reviewed every five years by HEFCE and may be reset if appropriate to reflect the changing nature of the provision of education and more general changes within public sector funding.

14. If two or more of the trigger indicators reduce to at least 30 per cent from the base level, this will lead to discussions between HEFCE and the institution about the impact of further downsizing, including consideration of whether to reset the base indicators.

15. If the triggers are activated, HEFCE has the right, but not the obligation, to request repayment. It has discretion to waive the requirement for repayment.

Annex H
Definitions and abbreviations

1992 Act	Further and Higher Education Act 1992
1998 Act	Teaching and Higher Education Act 1998
ASC	annualised servicing cost
Capital expenditure	expenditure used to create or purchase a new asset, replace an existing asset, or refurbish or remodel an existing asset
CIPFA	Chartered Institute of Public Finance and Accountancy
Combined Code	'The Combined Code on Corporate Governance', July 2003, Financial Reporting Council
CUC	Committee of University Chairmen
CUC Code of Practice	Guide for Members of Higher Education Governing Bodies in the UK: Governance Code of Practice and General Principles (HEFCE 2004/40a)
DEL	Department for Employment and Learning in Northern Ireland
Designated officer	head of an institution responsible and accountable to HEFCE (and ultimately to Parliament) for ensuring that the institution uses HEFCE funds in ways that are consistent with the purposes for which those funds were given, and complies with the conditions attached to them. These include the conditions set out in the Further and Higher Education Act 1992 and in this Financial Memorandum
DIUS	Department for Innovation, Universities and Skills
FEC	Further education college
FRS	Financial Reporting Standard
GIAS	Government Internal Audit Standards
Governing body	the university council, board of governors or other body ultimately responsible for the management and administration of the institution's revenue and property, and the conduct of its affairs
HE	Higher education
HEFCE	Higher Education Funding Council for England
HEFCEAS	HEFCE assurance service
HEI	Higher education institution
HESA	Higher Education Statistics Agency
ICAEW	Institute of Chartered Accountants in England and Wales
IIA	Institute of Internal Auditors
JANET	high-speed computer network supported by the seven higher and

	further education funding bodies, which links universities and colleges in the UK. SuperJANET is the enhanced network
Legally distinct entity	an organisation receiving HEFCE grant funding from an HEI to whom it is accountable, but operating independently from that HEI
LSC	Learning and Skills Council
NAO	National Audit Office
QAA	Quality Assurance Agency for Higher Education
RB	Related body (a non-HEI/FEC body through which significant levels of HEFCE funding are distributed or activities promoted)
Secretary of State	Secretary of State for Innovation, Universities and Skills
Single conversation	a streamlined accountability process between HEFCE and institutions, linked to an assessment of institutional risk, which comprises an exchange of documents and dialogue during a specific period each year
SORP	Statement of recommended practice
the Code	Accountability and Audit: HEFCE Code of Practice
TDA	Training and Development Agency for Schools
TRAC	Transparent Approach to Costing
VFM	Value for money

References to the financial position, financial statements, financial commitments or borrowings of the institution mean the consolidated financial position, financial statements, financial commitments or borrowing of the institution and its subsidiary undertakings, as defined in the Companies Act 1985 and revised by the Companies Act 1989 and 2006, and in accordance with generally accepted accounting principles.

Shall and **must** denote mandatory requirements, and **should** denotes our view of good practice.