Annex A: Financial statement, audit and value for money returns guidance

Audited financial statements

1. We ask higher education institutions (HEIs) to send us, via the secure area of the HEFCE web-site, one scanned PDF of their complete financial statements that has been signed by all the relevant parties. The financial statements shall be signed by the accountable officer and by the chair or one other member of the governing body appointed by that body.

2. HEIs are required to follow the latest version of the 'Statement of recommended practice: accounting for further and higher education' (SORP) in preparing their financial statements[7]. HEIs should also comply with 'HEFCE's Accounts direction to higher education institutions for 2013-14 financial statements' (HEFCE Circular letter 25/2013) and 'HEFCE's Accounts direction to higher education institutions for 2014-15 financial statements' (HEFCE Circular letter 25/2014). The audited financial statements should, as a minimum, include the following.

   a. A narrative report that should provide a comprehensive and balanced analysis of the institution's finances and operations, including the following information specified in the 2007 SORP.

      i. The development, performance and operation of the business and operation of the HEI during the financial year.

      ii. The position of the HEI at the end of the year.

      iii. The main trends and factors underlying the development, performance and position of the business of the HEI and its academic performance during the financial year.

      iv. The main trends and factors which are likely to affect the HEI's future development, performance and position.

   HEIs that are companies are also required to follow the 'Companies Act 2006 (Strategic Report and Directors Report) Regulations 2013'. In June 2014 the Financial Reporting Council published guidance on the requirements ('Guidance on the Strategic Report').

   b. A statement on internal control (corporate governance). In formulating their statements, HEIs should refer to best practice guidance, including guidance from the Institute of Chartered Accountants in England and Wales and the British Universities Finance Directors Group. As a minimum these disclosures should include an account of how the following broad principles of corporate governance have been applied.

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[7] The latest version of SORP (2007) is available at www.universitiesuk.ac.uk/highereducation/Pages/SORP.aspx.

i. The identification and management of risk should be an ongoing process linked to the achievement of institutional objectives.

ii. The approach to internal control should be risk-based, including an evaluation of the likelihood and impact of risks becoming a reality.

iii. Review procedures must cover business, operational and compliance as well as financial risk.

iv. Risk assessment and internal control should be embedded in ongoing operations.

v. The governing body or relevant committee should receive regular reports during the year on internal control and risk.

vi. The principal results of risk identification and evaluation, and management review of their effectiveness, should be reported to, and reviewed by, the governing body.

vii. The governing body must acknowledge that it is responsible for ensuring that a sound system of control is maintained, and that it has reviewed the effectiveness of the above process.

viii. Where appropriate, details of actions taken or proposed, to deal with significant internal control issues should be set out.

c. Where appropriate, a report in the corporate governance statement of its annual audited financial statements that the institution has had regard to the voluntary Committee of University Chairs (CUC) Governance Code of Practice contained in ‘Guide for members of higher education governing bodies in the UK: Incorporates the governance code of practice and general principles’ (HEFCE 2009/14). Where an HEI considers that it follows the Governance code of practice set out in the CUC guide, the University should state this in its annual financial statements in accordance with the guide. Conversely, where an HEI’s practices are not consistent with particular provisions of the Code, an explanation should be published in the financial statements which explain where it departs from the code and why. Adoption of the CUC Governance code of practice, with the principles of the Code adapted as appropriate to each HEI’s character, is an important factor in enabling HEFCE to rely on self-regulation within HEIs and hence minimise the accountability burden.

d. The external auditors shall report whether the following apply in all material respects (see Annex B paragraph 71 of the Financial Memorandum (HEFCE 2010/19)).

i. 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 cash flow for the year. They should take into account relevant statutory and other mandatory disclosure and accounting requirements, and HEFCE requirements.

ii. The financial statements have been properly prepared in accordance with the SORP, and sections 495 and 496 of the Companies Act 2006 (where the HEI is incorporated under the Companies Act), and any other legislative or regulatory requirements.

iii. 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.

iv. 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

e. Disclosures and reporting required to meet the institution's charitable obligations (see HEFCE 2010/19 Annex H for details).

3. New reporting requirements for HEIs that are exempt charities have been included in the Accounts direction for 2013-14. Guidance about these requirements is available at www.hefce.ac.uk/whatwedo/reg/charityreg/. For ease of reference the main requirements for 2013-14 are listed below.

a. The exempt or registered charitable status of the HEI.

b. The trustees who served at any time during the financial year and until the date the financial statements were formally approved.

c. A statement that the trustees of the charity have had regard to the Charity Commission's guidance on public benefit[8].

d. A report on how during the year the HEI has delivered its charitable purposes for the public benefit.

e. Information about payments to or on behalf of trustees, including: expenses; payments to trustees for serving as trustees (and waivers of such payments), and related party transactions involving trustees[9].

f. Details of HEIs 'paragraph 28' linked charities, as follows[10].

For each 'paragraph 28' (connected) charity that has income in the year of £100,000 or more, the following.

i. The name and charitable purpose.

ii. The opening balance, income and expenditure for the year, and closing balance.

For all other 'paragraph 28' charities, the following.

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[8] For detailed guidance see www.hefce.ac.uk/whatwedo/reg/charityreg/goodpracticeguidanceforinstitutionsascharities/reportingonthedeliveryofpublicbenefit/.

[9] For detailed guidance and materiality levels see www.hefce.ac.uk/whatwedo/reg/charityreg/goodpracticeguidanceforinstitutionsascharities/transactionswithtrustees/#section3.

[10] Under paragraph 28 of Schedule 3 of the 2011 Charities Act, an institution administered by or on behalf of an exempt charity is also an exempt charity.

iii. An analysis into appropriate groups (for example: prize funds, bursary or scholarship funds, research support funds) stating the number of entities in each group.

iv. For each group: the aggregate opening balances, income and expenditure for the year, and closing balances. (Note: the terms ‘opening’ and ‘closing’ balance should be interpreted as total reserves where a paragraph 28 charity is an operating charity.)

A possible (non-mandatory) layout for these linked charity disclosures is available in the guidance referred to above.

Audit committee annual report

4. As stated in the Audit Code of Practice (Annex B to HEFCE 2010/19) the HEI’s audit committee must produce an annual report for the governing body and the accountable officer. The audit committee’s annual report should cover the financial year 2013-14 and include any significant issues (including its consideration of the 2013-14 financial statements, internal and external audit reports) up to the date of preparation of the report. The audit committee annual report should normally be considered by the governing body before the annual financial statements are signed.

5. The audit committee annual report must include the committee’s conclusions 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 (VFM))
- management and quality assurance of data submitted to the Higher Education Statistics Agency and to HEFCE and other funding bodies. This latter assurance is to ensure adequate governance oversight of the systems used to generate funding data by the HEI, since poor data may represent a significant financial risk for HEIs that audit committees need to consider.

Note that the data opinion refers to all data submitted, including for franchised arrangements.

6. We require the three opinions to be included in the report; omission of an opinion or failure to support the opinion with reference to evidence is likely to be followed up in the risk letter or through other HEFCE contact. These opinions should be based on the information presented to the committee.

7. The report is likely to record the work of the committee over a period of 15 or 16 months up to the date of its presentation, and to consider the following:

- the information and assurances it has received to support its opinions
- the external auditors’ management letter (for 2012-13 and 2013-14)
- the internal auditors’ annual report (for 2012-13 and 2013-14)
- the committee’s consideration of the performance of the internal and external audit services
- any VFM work

- any HEFCE assurance service or other relevant evaluation.

8. The report might also identify any key issues for the HEI arising out of its activity over the year. This would include any fraud or other serious incidents.

9. If the annual VFM report is part of the Audit Committee report, it would be helpful if it could also be uploaded as a separate document so that it will be included in any summary analysis.

External audit management letter

10. External auditors should report to those charged with governance at each HEI (the governing body, audit committee or both) by way of an annual management letter and, if necessary, an audit issues memorandum that 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, and these must be submitted to HEFCE.

11. **Where issues are communicated through more than one report** (for example, a separate report covering information technology audits or governance issues, or one detailing management's responses), **the additional reports should also be submitted to HEFCE**. These should all be submitted **as a single document**.

Internal audit annual report

12. The internal audit annual report should relate to the financial year 2013-14 and include any significant issues up to the date of preparing the report that affect the opinion. This should be addressed to the governing body and the accountable officer, and should be considered by the audit committee.

13. 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.

We require both opinions to be included in the report; omission of an opinion or failure to support an opinion with evidence is likely to be followed up in the risk letter or through other HEFCE contact.

14. These opinions should be placed into their proper contexts: that is, the work undertaken should have 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 coverage achieved against the original audit plan. The annual report should also draw attention to any significant audit recommendations which the internal audit service considers have not received adequate management attention.

Efficiency and value for money

15. BIS has noted the need for the sector to make greater progress in delivering efficiencies and that students will expect value for the fees they pay. HEFCE has been asked to work with BIS and Treasury ministers, the Research Councils and vice-

chancellors to build on the Diamond and Wakeham reviews to drive further and faster improvements in efficiency. HEFCE is also working with Professor Sir Ian Diamond and Universities UK on the latest review of efficiency in higher education institutions. In this context, universities must continue to demonstrate good value for money and one way in which they can do so is share their annual VFM reports with HEFCE.

16. HEIs are therefore strongly encouraged to submit an annual VFM report as part of the annual accountability returns via the secure area of the HEFCE web-site by 1 December 2014. This is not a mandatory requirement, but this information will help provide a better-evidence base of VFM activities in the sector. The VFM reporting is intended to be a non-burdensome opportunity to demonstrate the value for money institutions provide to students and the taxpayer. HEFCE will not publish any individual reports but may use aggregated and anonymised information in reports, publications and policy making.

17. If provided, the report should provide commentary on how the HEI delivers economy, efficiency and effectiveness, in other words how the HEI makes the best use of its available resources to achieve the desired output and maximise its benefit.

18. As this is optional, there is no prescribed format for this report, and we are happy to accept an annual report produced for internal purposes, provided this is reviewed by the governing body (either by the board of governors or audit committee). Good practice guidelines for VFM activity and reporting may be found at www.hefce.ac.uk/whatwedo/reg/assurance/guidance/strategicmanagement/ under 'Value for money'.

19. However, institutions may wish to take into account the findings of a review of the VFM reports which formed part of the 2012 submissions. The full report can be found at www.hefce.ac.uk/whatwedo/reg/assurance/guidance/strategicmanagement/. The following areas of good practice in reporting value for money savings were identified:

- Structure
  - adopt a clear and logical structure for the report
  - be guided by the institution's VFM strategy and objectives
  - provide background information on key roles, approaches and so on
  - put VFM in context, (for instance, that of the Diamond report)
  - start at the strategic level and then drill down into specific areas
- Coverage
  - include coverage of academic and professional services departments
  - incorporate activities that generate additional income, as well as those that reduce costs or improve efficiency
  - include non-financial savings, such as staff time savings, improved efficiency and carbon reduction
  - consider quality issues, such as degree classifications and student satisfaction

- consider operational indicators of VFM, such as space usage and accommodation occupancy
- report past and current performance and summarise plans for future years

- <u>Content</u>
  - set out clearly what the report is for and how it will be used
  - explain what the institution is doing to achieve VFM and to realise savings
  - include narrative explanations and numerical details
  - try to include just the right amount of detail not too little, not too much
  - summarise progress in implementing the institution's VFM strategy
  - set out the institution's key VFM achievements
  - include information on suitable VFM benchmarks and performance against them
- <u>Savings</u>
  - work through all significant costs, rather than just focusing on the main areas of savings
  - include, where possible, a clear list of savings made, perhaps aggregated at department level
  - categorise savings by approach, (for instance tendering or negotiation), or by specific initiative
  - consider strategic and operational VFM initiatives (perhaps just give examples of the latter if there are a lot of them)
- <u>Other</u>
  - include the institution's VFM policy or strategy as an annex to the report.