

# Supplement B

to Circular 01/04

## Audit Issues



**Learning+Skills Council**

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## Further information

For further information, please contact the appropriate local Learning and Skills Council office, or write to:

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# Supplement B: Audit Issues

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## Introduction

1 Following the changes in the arrangements for individualised student record (ISR) audit, the Council is in the process of revising the Audit Code of Practice. The updated code will include revised model engagement letters between colleges and their financial statements' auditors. It will also include revised model audit opinions, incorporating changes proposed in bulletins issued by the Auditing Practices Board (APB). The Council recognises that colleges will need to have revised engagement letters in place prior to the audit of 2000/01 financial statements and, in order to give colleges early sight of this information, has included various audit issues in this supplement to the sector accounting policies circular.

## Audit Opinion 2000/01

2 The key changes to the 2000/01 audit opinion are:

- the use of funds audit opinion has been amended to state "in all material respects". This reflects the reality of an audit in that samples of transaction and balances are reviewed. The amended wording is consistent with the wording in the opinion on the ISR and APB Practice Note 10
- similarly the opinion on compliance with the financial memorandum is

amended to state 'in all material respects'.

The full wording of the proposed opinion is set out in annex A.

3 There are some areas that the Council regards as material by nature rather than by size and these are discussed at paragraphs 16 onwards.

## Audit Opinion 2001/02

4 Further revisions to the audit opinion are proposed for the year ended 31 July 2002. These are based on Auditing Practices Board (APB) Bulletin 2001/02 'Revisions to the Wording of Auditors' Reports on Financial Statements and the Interim Review Report' and APB Bulletin 2001/01 'The Electronic Publication of Auditors' Reports'. The engagement letter needs to incorporate the requirements of these bulletins.

5 Some external auditors may wish to use this revised opinion for the year to 31 July 2001. In those cases, the updated engagement letter will also need to be in place.

6 APB bulletin 2001/02 includes new example audit reports for financial periods commencing on or after 22 December 2000. The Council proposes to include these amendments in the standard unqualified audit opinions for the year ended 31 July 2002. The full wording of the proposed opinion is set out in annex B.

7 APB bulletin 2001/02 incorporates two main changes:

- Title  
The title of the audit report is amended to 'Independent Auditors' Report to....'. This distinguishes the external auditors' report from reports that might be issued by college management, governors or internal auditors who do not have to follow the same guidance that applies to independent auditors
- Electronic Publication  
An increasing number of organisations and potentially colleges, are publishing their financial statements on a web site. It is also recognised that in time the Council may request electronic returns of accounts.

8 The auditors' report included with any financial statements published on the web site will be consistent with the auditors' report in the printed manually signed accounts. Depending on the format used to publish information on the web site the accounts may look the same as the manual version (for example a PDF file which retains the same page numbers) or may change the format (for example HTML format will not identify the page numbers audited in the same way). For this reason the method for identifying the financial statements audited changes from page numbers to a more detailed description of what has been audited.

9 Where the auditors' report is to be published on a web site, the following words will be included (in the web site version):

- The maintenance and integrity of the Casterbridge College web site is the responsibility of the college, the work carried out by the auditors does not

involve consideration of these matters and accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site

- Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

## Engagement Letters

### 2000/01

10 A revised model engagement letter is set out at annex C.

11 The engagement letter is substantially the same as the model letter in the current audit code of practice with references to statistical returns removed.

12 Paragraphs 28-32 of the model letter are new and represent current best practice.

### 2001/02

13 The model engagement letter will need to be updated to include changes proposed in APB bulletin 2001/01 to reflect the respective responsibilities of the auditor and the college manager in respect of financial statements published electronically. Changes include:

- acknowledgement that the auditors recognise that the college may wish to publish its financial statements and the auditors' report on its web site or distribute them by means such as email
- noting that it is the responsibility of the college to ensure that any such publication properly presents the financial information and any auditors' report and that the college is

responsible for controls over and security of the web site

- establishing that the college will advise the auditors of any intended electronic publication before it occurs
- stating that the auditors reserve the right to withhold consent to the electronic publication of their report if the audited financial statements or the auditors' report are to be published in an inappropriate manner
- stating that the examination of the controls over the maintenance and integrity of the college's web site is beyond the scope of the audit of the college's financial statements
- stating that the college is responsible for establishing and controlling the process for electronic distribution of financial statements to third parties and to the council.

14 A suggested wording is set out below:

*We acknowledge that the college may wish to publish its financial statements on its web site.*

*As members of the college's governing body you are required to ensure that any such publication properly presents the financial information and the auditors' report.*

*You will advise us in advance of any intended electronic publication before it occurs.*

*As auditors we reserve the right to withhold consent to the electronic publication of our report if the audited financial statements or the auditors' report are to be published in an inappropriate manner.*

*As members of the governing body, you are responsible for the controls over, and the security of, the web site. Any examination of such controls is beyond the scope of the audit of the financial statements.*

15 These changes will be incorporated into a model engagement letter to be included in the new Audit Code of Practice, when published.

## Use of funds audit opinion

16 In addition to participation funds, which are generally for activity recorded on the ISR, the Council makes available to colleges funds under a number of initiatives. In giving their audit opinion on the use of funds, external auditors should consider funds received under each of these initiatives. The main blocks of funding are listed below.

### Learner support funds

17 FEFC circular 00/14 covers the arrangements for learner support funds for 2000/01. Learner support funds comprise five separate allocations to meet:

- general access needs for further and higher education students
- additional costs faced by mature full-time HE undergraduate students
- child care costs for FE students
- residential accommodation costs for FE student who have to live away from home.

18 As part of their audit opinion on the college's financial statements external auditors are required to give an opinion that these funds have been used for the purposes intended. Under the SORP access funds are recorded as a memorandum note at the end of the financial statements. This does not exclude them from the use of funds opinion.

### Funding for childcare places 2000/01

19 Project funds are available for funding new childcare places. Project details and eligibility criteria are set out in FEFC circular 00/21.

### Inclusive learning quality initiative

20 Institutions had until March 2001 to use funds made available under the inclusive learning quality initiative. Details can be found in FEFC circular 99/50.

### Rationalisation fund

21 Details of projects eligible for rationalisation funds for 1999/2002 are set out in FEFC circular 99/15.

### Standards fund

22 The arrangements for using the standards fund in 2000/01 are set out in FEFC circular 00/15.

### Capital grants

23 Colleges in receipt of grants for major capital projects will have a separate funding agreement setting out the terms and conditions of that grant.

# Annex A: Revised model audit opinion for 2000/01

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## Auditors' Report to the Members of the Corporation

We have audited the financial statements on pages x to x which were prepared in accordance with the accounting policies set out on pages x and x.

## Respective responsibilities of the members of the corporation and auditors

As described on page x, the members of the corporation are responsible for the preparation of the financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

## Basis of our opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by members of the corporation in the preparation of the financial statements, and of whether the accounting policies are appropriate to the college's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

## Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the college and the group as at 31 July 2001 and of the group's deficit of income over expenditure for the year then ended.

In our opinion, in all material respects, funds from whatever source administered by the college for specific purposes were properly applied for the intended purposes and, where relevant, managed in accordance with appropriate legislation for the year ended 31 July 2001.

In our opinion, in all material respects, funds provided by the [name of funding body] were applied in accordance with the financial memorandum and any other terms and conditions attached to them for the year ended 31 July 2001.



# Annex B: Revised model audit opinion for 2001/02

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## **Independent Auditors' Report to the Members of the Corporation**

We have audited the financial statements of Casterbridge College for the year ended 31 July .... which comprise the income and expenditure account, the balance sheet, the cashflow statement, the statement of total recognised gains and losses and the related notes.

These financial statements were prepared under the historical cost convention, as modified by the revaluation of certain fixed assets, and the accounting policies set out therein.

## **Respective responsibilities of the members of the corporation and auditors**

As described in the statement of members' responsibilities, the members of the corporation are responsible for the preparation of the financial statements in accordance with applicable law and United Kingdom Accounting Standards.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the financial statements give a true and fair view. We also report to you whether, in our opinion monies expended out of funds from whatever source administered by the college

for specific purposes were properly applied for those purposes and where relevant managed in accordance with appropriate legislation and whether monies expended out of funds provided by the Learning and Skills Council/Further Education Funding Council were applied in accordance with the financial memorandum and any other terms and conditions attached to them.

We also report to you if, in our opinion, the members' report is not consistent with the financial statements, if the college has not kept proper accounting records or if we have not received all the information and explanations we require for our audit.

We read the members' report and consider the implications for our report if we become aware of any apparent misstatements within it.

## **Basis of our opinion**

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by members of the corporation in the preparation of the financial statements, and of whether the accounting policies are appropriate to the college's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

## Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the college and the group as at 31 July 2001 and of the group's deficit of income over expenditure for the year then ended.

In our opinion, in all material respects, funds from whatever source administered by the college for specific purposes were properly applied for the intended purposes and, where relevant, managed in accordance with appropriate legislation for the year ended 31 July 2001.

In our opinion, in all material respects, funds provided by the [name of funding body] were applied in accordance with the financial memorandum and any other terms and conditions attached to them for the year ended 31 July 2001.

# Annex C: Revised model engagement letter between colleges and external auditors

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Dear Sirs

## Letter of engagement for audit of financial statements

1 Following our appointment as external auditors of ..... College (the college) [and its subsidiaries], we set out below what we consider to be the basis on which we are to act as external auditors to the college and the respective areas of responsibility of the college and of ourselves. This engagement letter incorporates the requirements of the model letter of engagement for college external auditors set by the Learning and Skills Council (the Council).

### Appointment and qualification

2 We acknowledge that the governing body will annually reconsider the reappointment of the external auditors. Remuneration will be fixed annually by the governing body on the advice of the audit committee. A new competition for the selection of auditors will be held at least every five years.

3 We confirm that we are qualified to be appointed as external auditors for the college in accordance with the requirements of paragraph 52 of the Council's audit code of practice. We shall have right of access at all times to the books, accounts and vouchers of the college, minutes of the governing body and management meetings, and such information and explanations as are necessary for the

performance of our duties in accordance with the requirements of the Council.

### Responsibilities of the college

4 The governing body shall be responsible for ensuring that:

- a. a system of controls, financial and otherwise, is established and maintained in order to carry on the operations of the college in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure, as far as possible, the completeness and accuracy of the records ('the whole system of internal control');
- b. proper accounting records are maintained;
- c. financial statements are prepared that:
  - i. comply with the college's articles of government, all relevant statutory requirements, the financial memorandum between the Council and the college, the Council's accounts directions, and any other regulations relevant to the constitution and activities of the college
  - ii. show a true and fair view of the college's financial position and of the income and expenditure for the year taking into account where relevant: statutory disclosure requirements, Statements of Standard Accounting Practice, Financial Reporting Standards and other accounting standards recommended by the Accounting Standards Board (or its predecessor the Accounting Practices

Committee) and the accounting requirements of the Council;

- d. monies expended out of funds from whatever source administered by the college for specific purposes are properly applied for those purposes and managed in compliance with relevant legislation;
- e. monies expended out of funds provided by the Council were applied in accordance with the financial memorandum between the Council and the college and any other terms and conditions attached to them.

### Audit reporting

5 We shall make a report to the governing body on the financial statements examined by us, copies of which are to be laid before the governing body during our tenure of office.

6 Our report shall state whether in our opinion the financial statements show a true and fair view and whether they were properly prepared in accordance with 4(c) (ii) above.

7 We shall also report to the governing body whether:

- a. in our opinion, in all material respects, monies expended out of funds from whatever source administered by the college for specific purposes were properly applied for those purposes and, if appropriate, managed in compliance with relevant legislation; and
- b. in our opinion, in all material respects monies expended out of funds provided by the Council were applied in accordance with the financial memorandum between the Council and the college and any other terms and conditions attached to them.

8 In arriving at our opinion we are also required to consider the following matters, and to report on any aspect of which we are not satisfied:

- a. whether proper accounting records were kept by the college;
- b. whether the college's balance sheet and income and expenditure account are in agreement with the accounting records;
- c. whether we have obtained all the information and explanations which we consider necessary for the purposes of our audit;
- d. whether the information given in the report of the governing body is consistent with the financial statements.

9 We have a professional responsibility to report if the financial statements do not comply in any material respect with applicable accounting standards and the requirements of the Council, unless in our opinion the non-compliance is justified in the circumstances. In determining whether or not the departure is justified, we will consider:

- a. whether the departure is required in order for the financial statements to give a true and fair view and;
- b. whether adequate disclosure was made concerning the departure.

10 If the college is a limited company this paragraph should be inserted. In preparing our report it is our duty to carry out such investigations as will enable us to form an opinion as to whether:

- a. the college's financial statements are in agreement with the accounting records;
- b. the financial statements comply with the *Companies Act*.

11 A model unqualified audit report is given in the supplement issued with the most recent edition of the Council's circular *Sector Accounting Policies*. We will not depart from the model without consulting with the

Council's assistant director: provider financial support and assurance.

12 We shall report by way of management letter, to the governing body through the audit committee, when we issue our opinion on the annual financial statements. The management letter shall include any significant matters arising out of the audit that might lead to material errors or impact on future audits, or where, for example, economies can be made or resources used more efficiently. It shall also recommend improvements, particularly in the following areas:

- a. weaknesses in the structure of accounting systems and the whole system of internal control;
- b. deficiencies in the operation of accounting systems and the whole system of internal control including, where appropriate, internal audit;
- c. inappropriate accounting policies and practices;
- d. non-compliance with legislation, accounting standards, other regulations and Council requirements; and
- e. matters raised in previous management letters where remedial action remains incomplete.

13 A copy of the management letter, including those issues arising from any interim audit and other reports of audit findings shall be sent by us direct to the head of the provider financial assurance team in the relevant Local Learning and Skills Council at the same time as the original is sent to the college. Only final versions, including the college's reply, of such documents will be sent to the Council.

14 Where serious weaknesses or an accounting breakdown or other control breakdown is identified, it shall be reported to the Principal, the Chair of the governing body, and the Chair of the Audit Committee without

delay. Such weaknesses or breakdowns shall be reported to the chief executive of the Council, copied to the assistant director: provider financial assurance or other designated individual.

### Audit scope

15 We shall conduct our audit of the college's financial statements and such other matters as the governing body require in accordance with approved auditing standards issued by the Auditing Practices Board and in full accordance with any instructions issued by the Council.

16 The nature and extent of our procedures will vary according to our assessment of the college's accounting system, and where we wish to place reliance on it, the internal control system, and may cover any aspect of the college's operations that we consider appropriate.

17 As part of our normal audit procedures, we may request you to provide written confirmation of certain oral representations which we have received from you during the course of the audit on matters having a material effect on the financial statements.

18 We will review the working papers of internal auditors, to the extent that we propose to rely on them.

19 The Council will issue a certificate each year confirming the amount of recurrent grant funding to be included within the college's financial statements. We intend to rely upon that certification subject to our assessment of the third party evidence.

### Access

20 We expect to have unrestricted access to the files and working papers of the college's internal audit service, and to have regular meetings with internal audit personnel. We expect to have the right to hold meetings with the Council's appointed student number auditor as required. The external working

papers are the property of[ ]. In the event of a request from the Council's audit service or NAO, access to working papers obtained or prepared during the course of our audit will be provided on the exchange of appropriate 'hold harmless' letters.

### Irregularities, including Fraud

21 Ensuring the establishment and maintenance of an adequate system of internal control is the responsibility of the governing body with which rests also the responsibility for ensuring compliance with statutory and other regulations, including those in relation to taxation, and for the prevention and detection of irregularities, including fraud and corruption. We shall plan and conduct our audit so that we have a reasonable expectation of detecting material mis-statements in the accounts resulting from irregularities, including fraud or corruption, or breach of regulations. However, we are not required under this letter of engagement to search specifically for irregularities and fraud and corruption and our audit should not therefore be relied on to disclose them. We shall report to the Council's chief executive, copied to the assistant director provider financial support and assurance, without delay, any serious weaknesses, significant frauds, major accounting and other control breakdowns of which we become aware.

### Other work

22 We may also be asked from time to time to provide additional services, including value for money or other investigations, beyond the scope of the audit described in this letter of engagement. Precise requirements will be agreed between ourselves and the governing body, and set out under a separate letter of engagement. In these circumstances both ourselves and the governing body must be satisfied that no conflict of interest could, or

be perceived to, arise.

### General meeting

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

### Termination of appointment

24 The governing body may by resolution remove us as the college's external auditors before the expiration of our term of office, notwithstanding any agreement between us and the college. We, as the college's external auditors, may resign before the end of our term of office.

### Fees

25 Our fee for the audit of the college for the year ended 31 July 2001 is £..... Our fee is fully inclusive, except for the addition of value added tax. Our audit fees in the future would be agreed with you on an annual basis in line with the terms of our appointment.

26 Invoices for our audit fees will be raised as our work progresses.

27 Fees for additional assignments which you may commission outside the scope of the annual external audit would be agreed with you in writing in advance of the work, together with terms of reference and an estimate of the timescale involved.

### Complaints procedures

28 If at any time you would like to discuss with us how the Services can be improved or if you have a complaint about them, you are invited to telephone xxxxxxxx. If your problem is not resolved, you should contact [ ], our UK Senior Partner, either by writing to him

at [ ] or through our client care website at [http://www.\[ \]](http://www.[ ]). We will investigate any complaint promptly and do what we can to resolve the difficulties. If you are still not satisfied, you can refer the matter to the Institute of Chartered Accountants in England & Wales.

Confidentiality

29 We confirm that where you give us confidential information, we shall at all times keep it confidential, except as required by law or as provided for in regularity, ethical or other professional pronouncements applicable to our engagement. You agree that it will be sufficient compliance with our duty of confidence for us to take such steps as we in good faith think fit to preserve confidential information both during and after termination of this engagement. We have a professional duty to disclose, on request, our audit working papers and other relevant information to the ICAEW and its Joint Monitoring Unit.

Electronic communication

30 During the engagement we may from time to time communicate electronically with each other. However, the electronic transmission of information cannot be guaranteed to be secure or virus or error free and such information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete or otherwise be adversely affected or unsafe to use. We recognise that systems and procedures cannot be a guarantee that transmissions will be unaffected by such hazard.

31 We confirm that we each accept the risks of and authorise electronic communications between us. We each agree to use commercially reasonable procedures to check for the most commonly known viruses before sending information electronically. We shall each be responsible for protecting our own systems and interests in relation to electronic communications and the Council and [the firm]

(in each case including our respective partners, employees, agents or officers) shall have no liability to each other on any basis, whether in contract, tort (including negligence) or otherwise, in respect of any error, damage, loss or omission arising from or in connection with the electronic communication of information between us and our reliance on such information.

Applicable law

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

Agreement of terms

33 If the contents of this letter are not in accordance with your understanding of the arrangements made, we shall be pleased to receive your observations and to give you any further information you require. Otherwise, we should be grateful if you would confirm in writing your agreement to the terms of this letter by signing the enclosed copy and returning it to us.

Yours faithfully

On behalf of the governing body

I confirm the above terms in respect of

.....  
Signed .....  
Name .....  
Position .....  
Date .....

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