

Audit

Interim Audit Code of Practice

Summary

This circular introduces the interim Audit Code of Practice ('the code') for the post-16 education and training sector which is effective until further notice and supersedes the code set out in FEFC Circular 98/15. It also reports on the outcome of consultation on changes to the audit requirements for FE colleges.

The Learning and Skills Council (LSC) is working towards developing a common approach to funding all of its provision. This interim code will then be replaced by a new code, following a full consultative review.

This circular is of interest to management, governors and auditors of FE colleges and providers within the post-16 education and training sector that are funded by the LSC, and to executive directors, finance directors and heads of provider financial assurance at local LSCs.

Supersedes

FEFC Circular 98/15



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Supplements:

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- B Annexes to the Interim Audit Code of Practice

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Executive Summary

Date: February 2003

Subject: The purpose of this circular is to introduce the interim Audit Code of Practice ('the code') that applies to the post-16 education and training sector until further notice. The code includes the mandatory audit arrangements for further education (FE) colleges as well as summarising the audit arrangements for the LSC's principal funding of other providers.

This circular also reports on progress made in response to the recommendations of the Bureaucracy Taskforce in respect of the LSC's audit requirements of FE colleges and providers.

This circular further reports on the outcome of consultation set out in a letter to FE colleges and auditors dated 29 July 2002. That letter consulted on changes to the mandatory audit requirements for FE colleges that were set out in the Further Education Funding Council (FEFC) audit code (FEFC Circular 98/15). The interim code reflects the majority of the comments received.

Intended recipients: This circular and the code will be of interest to all providers of education and training in the post-16 sector, including those working in FE colleges and sixth form colleges, and those providing work-based learning and adult and community learning. The code is recommended for senior management, members of management teams and governors and auditors of learning providers that receive LSC funding. Other recipients include executive directors, finance directors and heads of provider financial assurance at local LSCs, and other bodies with an interest in audit such as the Higher Education Funding Council for England.

Status: For information and action.

Interim Audit Code of Practice

Introduction

1 This circular introduces the interim audit code of practice ('the code') and reports on the outcome of the consultation with further education (FE) colleges in a letter dated 29 July 2002.

2 Two working groups have been advising the LSC on the interim code and proposals for further developments. The code working group included representatives from the Association of Colleges/Association of College Registrars and Administrators (AoC/ACRA), the Association of Learning Providers (ALP), the Department for Education and Skills (DfES), the National Audit Office (NAO) and auditing firms. The internal audit working group included representatives of FE college internal audit services. The code working group met on four occasions and the internal audit working group met twice. Both groups considered the responses to the consultation, and their views have influenced the code. Membership of the two groups is given in Annex A. The AoC has agreed and endorses the code. The LSC thanks both working groups for their contribution.

Structure

3 The main body of this circular provides an introduction and background to the code and the consultation that preceded it.

4 Supplement A contains the code. Supplement B includes model documents for adoption under the code by FE college audit committees, their internal audit service and financial statements (also known as 'external') auditors.

Guidance

5 The code focuses on mandatory audit requirements for FE colleges and those model

documents needed to meet these mandatory requirements. There are no supplementary guidance notes. The majority of those responding to the consultation on the code indicated that they did want the LSC to develop guidance notes, and this will be done in due course. In the meantime, the LSC and AoC/ACRA, with assistance from auditors, intend to invite FE colleges, providers and their auditors to regional seminars on the code in early 2003.

6 FE colleges and providers with queries on how to apply the code may also wish to consult their auditors or the LSC. The LSC can be contacted by email at audit.code@lsc.gov.uk or by telephone to the head of provider financial assurance in each local LSC.

Future developments

7 The LSC intends to keep the operation of the code under review and will consult interested parties before making any significant amendments.

8 Audit arrangements are a direct product of the LSC's terms and conditions of funding and the LSC will be looking to harmonise these arrangements as far as possible. The LSC intends to integrate its harmonised audit arrangements into later versions of the code, so that the code will eventually be a condition of funding for all providers.

Background

Accountability

9 In May 1998 the FEFC published Circular 98/15, *Audit Code of Practice for FE Colleges* (the 1998 code). This defined the FEFC's mandatory requirements for audit and

provided guidance. The code was for FE college managers, governing bodies, audit committees, internal audit services and financial statements auditors. The 1998 code demonstrated that FE colleges operated within a robust accountability framework.

10 The LSC has inherited the responsibilities and processes of the FEFC. The LSC funds a greater range of post-16 learning providers than the FEFC did, and therefore the 1998 code was not sufficiently wide-ranging for the scope of the LSC's work. In addition, the LSC needed to consider how it would deal with developments in FE colleges' accountability since 1998, including the following considerations:

- Statutory changes to audit requirements set out in the Instrument and Articles of Government for FE colleges were last reissued in March 2001. These changes included the statutory appointment of an internal audit service and separation of this service from the financial statements audit.
- Where not subsequently incorporated in statute, additional ministerial requirements were announced in April 1999 for FE colleges' audit arrangements. In particular the LSC took responsibility for FE colleges' funding (learner numbers) audits from 2000/01.
- Other developments came as a result of changes in auditing practice within government, particularly the adoption of the Turnbull Report by the public sector and the introduction of the Government Internal Audit Standards in 2001.
- The outcomes of the work of the Bureaucracy Taskforce (BTF) have also influenced the need for a revised code.

Reducing bureaucracy

11 The LSC established the BTF in autumn 2001. It is chaired by Sir George Sweeney, a

Council member and the principal of Knowsley Community College. The BTF's remit, in its first year of work, was to review bureaucracy on FE colleges, and it reported its findings in November 2002.

12 One area the BTF considered at length was the audit of FE colleges. Its members raised significant concerns about the extent and frequency of audit, particularly funding audit, and duplication between audit and inspection. The BTF accepted that the extent of FE college funding audit was largely a direct product of the nature of the funding methodology.

13 In the light of the work of the BTF, the LSC considered whether to issue a code at all. The decision to issue an interim code was based on the following factors.

- For FE colleges, the statutory Articles of Government charge the LSC with setting out its required audit arrangements. The LSC has a unique role as the regulator of FE colleges' accountability for public funds and the LSC must give its requirements in some form.
- While other providers have their full and formal audit requirements set out in their many different funding agreements, the LSC is seeking in future to consolidate its audit requirements into its code, as for FE colleges. The audit arrangements relevant to the provider in the code would then become a condition of funding or contract. Much that was in the 1998 code concerned requirements for internal audit, financial statements audit and audit committees. These requirements were based on well-established public sector norms that have not significantly changed since.
- Most other government funding bodies have developed their own code in recognition of general good practice.
- The code working group has indicated that an updated code would be beneficial.

Audit process

14 While still issuing a code, the LSC is fully committed to carrying out the BTF's recommendations. Many of the BTF's concerns were about the funding audit. The LSC imposes few actual requirements through the code on FE colleges for the funding audit. Most of the process of the funding audit is an administrative activity by the LSC itself and hence is outside the scope of the code.

15 The code therefore only deals with those parts of the funding audit process where FE colleges are required to directly support the process. The chief executive's announcement in November 2002 at the AoC annual conference, of less frequent funding audits for pilot and pathfinder FE colleges will influence the future development of the code.

16 The code continues to be mainly about the arrangements that statute and the LSC require FE colleges to put in place for the audit of their annual financial statements and of their risk management, control and governance processes. The LSC expects FE colleges themselves, as independent corporations, to organise and monitor the whole process of the financial statements audit and internal audit.

17 The BTF recommended that the LSC should establish single monitoring/audit arrangements for all LSC funding streams to FE colleges. Under the 1998 code, FE colleges' internal audit services and financial statements auditors already had responsibility for auditing all their activities. Separate audits exist for some other LSC funding of FE colleges, particularly work-based learning (WBL). In response, the LSC will during 2002/03 transfer responsibility for the audit of FE colleges' WBL provision from approximately half of the 47 local LSC provider financial assurance (PFA) functions to the LSC's appointed auditors of FE colleges' funding claims for FE provision. The remaining transfers of the audit of WBL and other funding of FE colleges will take place from 2003/04 onwards.

Duplication

18 The BTF also recommended that the LSC should continue discussions with the Adult Learning Inspectorate (ALI), the Office for Standards in Education (OfSTED) and other relevant organisations so that audit and inspection can be complementary and supportive activities and so that the scope of monitoring, audit and inspection are aligned.

19 The LSC acknowledges the large number of review agencies at work in FE colleges and other providers. Many of these agencies are far removed from the LSC's responsibilities for funding FE colleges. Other agencies are working in parallel or overlapping areas to the LSC itself. The LSC will be seeking to work with these agencies to eliminate duplication and overlap.

20 Where this is under the LSC's control, one means of eliminating duplication is to combine the audit functions, as described in paragraph 17. Where this is not possible due to the statutory or other independence of other agencies, the LSC will be seeking reciprocal, parallel, lead or reliance arrangements.

21 The LSC has reaffirmed its reciprocal arrangements with the Higher Education Funding LSC for England (HEFCE) by which each funding body performs all financial assurance functions on behalf of the other at the FE colleges and higher education (HE) institutions for which they have responsibility.

22 The LSC also agreed a concordat in April 2001 with OfSTED and ALI. Under the concordat, the LSC shares information with the inspectorates in support of their work. The LSC's PFA joint national-local teams examine financial management and where appropriate governance in parallel with inspection of FE colleges and for other providers receiving significant funding.

23 As part of the development of the code, the LSC consulted on whether FE college internal audit services should seek to accept assurances from the LSC's appointed funding auditors on the state of FE colleges'

management information systems used to produce the FE college's funding claims.

24 Under the code, the LSC will offer a statement of assurance, where this statement is available, to FE college internal auditors. It is then for FE college audit committees and internal auditors to decide on whether to accept the statement, and limit their own work accordingly. There may be occasions when the statement is not available, such as when an annual funding audit is no longer required for pilot and pathfinder FE colleges.

Other reductions in bureaucracy

25 In addition to changes made in response to BTF recommendations, the LSC has taken the following actions to reduce bureaucracy.

- From 2001/02 onwards, the requirement on FE colleges and WBL providers to submit fully evidenced funding claims monthly before payment can be made in arrears is removed. LSC assurance processes are now focused on sampling evidence held by the provider *in situ*.
- Revised and simplified definitions of what is acceptable evidence of WBL provision are in use. These definitions put the emphasis on substance over form.

26 In the future development of the code, the LSC will have close regard to the recommendations of the BTF and the need to minimise requirements on providers, subject to maintaining public accountability.

Responses to Consultation

27 The letter dated 29 July 2002 consulted on the LSC's requirements on FE colleges for their arrangements for internal audit, financial statements audit and audit committees. The LSC has considered each of these three main elements for their continued appropriateness and has concluded that they are essential in ensuring sound and effective internal control,

financial management and governance within FE colleges.

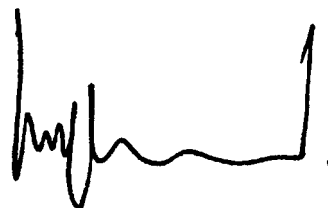
28 These arrangements also remain the primary sources of assurance to the LSC on the state of FE colleges' systems of internal control and their proper use of public funds. The DfES has confirmed the need for the LSC to retain all three elements of the code.

29 The LSC received 218 responses to the consultation letter dated 29 July 2002. The LSC wishes to thank respondents for contributing to the consultation process. Responses were received from:

- AoC/ACRA;
- 196 FE colleges including governing bodies, audit committees, clerks to the governing bodies, principals and finance directors;
- 19 accountancy firms including one in-house internal audit provider;
- Association of Chartered Certified Accountants; and
- NAO.

30 A summary of the responses to the consultation and the response from the LSC is attached at Annex B.

31 The code incorporates changes arising from responses to the consultation, most of which seek to reduce the LSC's intervention in FE colleges' audit arrangements.



John Harwood, Chief Executive

Annex A: Membership of Working Groups

Audit Code of Practice Working Group

James Bishop*	Quality Assurance Manager, JT Limited
David Coates+	Clerk to the Corporation, The People's College Nottingham, West Nottinghamshire College and East Riding College; member of the Association of Colleges and Association of College Registrars and Administrators Steering Committee
Phil Eames	Assurance Manager, Learning and Skills Council
Patrick Green	Partner, Bentley Jennison
Karen Hagan+	Finance Director, Somerset College of Arts and Technology; Vice-chair, Colleges Finance Directors Group
Ian Mason	Assurance Manager, Learning and Skills Council
Louise Mellor	National ISR Contract Manager, Learning and Skills Council
Peter Newson	Assistant Director, Provider Financial Assurance, Learning and Skills Council
Mike Rowley	Director, KPMG LLP
Adrian Rutter	Director, Risk & Assurance Services Tenon Ltd; Director, Public Sector Services Blueprint Audit Ltd
Pauline Tiller	Director of Finance and Policy, Learning and Skills Council Kent and Medway
Martin Wilson	Governance and Organisation Team, Department for Education and Skills
Philip Wood	Auditor, NAO
Vickie Wood	Governance and Organisation Team, Department for Education and Skills

* *nominated by the Association of Learning Providers*

+ *nominated by the Association of Colleges*

Internal Audit Working Group

Mike Benford	Manager, Tenon Limited
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Paula Dutton	Partner, BDO Stoy Hayward
Ian Falconer	Partner, RSM Robson Rhodes
Tony Felthouse	Senior Manager, KPMG LLP
Patrick Green	Partner, Bentley Jennison
Martin Hill	Director of Audit Services, East Riding Audit Consortium
Ian Mason	Assurance Manager, Learning and Skills Council
David Morris	Manager, MacIntyre Hudson
Helen Morris	Manager, Bentley Jennison
Sarah Nattress	Manager, PricewaterhouseCoopers
Peter Newson	Assistant Director, Provider Financial Assurance, Learning and Skills Council
Robin Pritchard	Partner, Pritchard Wood
Mike Rowley	Director, KPMG LLP
Adrian Rutter	Director, Risk & Assurance Services Tenon Ltd; Director, Public Sector Services Blueprint Audit Ltd
Karen Shaw	Manager, Hampshire Audit Services

Annex B: Responses to Consultation

Consultation area	Supportive %	Not supportive %	Other/ no view %	Comments
Guidance				
1 Should the LSC develop detailed guidance notes to support the interim code?	80	6	14	The responses that were not supportive wanted the guidance to be issued by the FE colleges themselves, the Association of Colleges, their auditors or did not say. 4% of responses did not want any guidance issued at all. <i>The LSC will seek to work with FE college and provider representative bodies to issue guidance in 2003.</i>
Audit committee				
2 Should governing bodies be permitted to approve the FE college's annual financial statements on the advice of either the FE college's finance committee or its audit committee?	74	20	6	Most of the 'not supportive' responses were concerned about the audit committee's independence. <i>The interim code will permit governing bodies to approve the FE college's annual financial statements on the advice of the FE college's finance committee or its audit committee or both of these committees.</i>

Consultation area	Supportive %	Not supportive %	Other/ no view %	Comments
<ul style="list-style-type: none"> involvement in the receipt of, consideration of and giving advice to the governing body on the results of the work of the FE college's internal audit service, financial statements auditor and the auditor appointed by the LSC for the FE college's funding claims; and involvement in the setting and reviewing of performance indicators for the FE college internal audit service and financial statements auditor. 	96	2	2	
Internal audit				
<p>5 Should the FE college internal audit service either:</p> <ul style="list-style-type: none"> seek to rely on the work of the LSC's contractor for the audit of FE colleges' funding claims; or accept assurance from the LSC on the FE college's learner numbers systems, based upon the work of the LSC's contractors for the audit of FE colleges' funding claims. 	24	0	22	<p>A number of responses expressed reservations about:</p> <ul style="list-style-type: none"> the timing of the assurances that would be given by the LSC; the audit coverage of the learner numbers system by the funding auditors being restricted to certain areas of the learner numbers system; and the erosion of independence of FE college internal audit.

Consultation area	Supportive %	Not supportive %	Other/ no view %	Comments
				<p>The LSC will offer assurance, where available, on the FE college's learner numbers systems but the FE college's audit committee and internal audit service will decide whether to accept it. There may be occasions when the statement is not available, for example, for those colleges not subject to an annual funding audit.</p>
<p>Areas common to financial statements and internal auditors</p>				
<p>6 Should FE colleges be required to send to the LSC for comment, prior to the contract being awarded, the proposal documents and draft letter of engagement for the successfully tendering audit provider?</p>	<p>51</p>	<p>0</p>	<p>49</p>	<p>There was a range of responses over this consultation area which was intended to simplify arrangements by abolishing the requirement for FE colleges to send in every audit proposal to the local LSC for comment.</p> <p><i>The LSC places very significant reliance on the work of FE college financial statements auditors and FE college internal audit services and so has to ensure that the proposed audit appointment can deliver reliable assurance. As a minimum, the LSC intends to ensure that the FE college's proposed appointment meets its requirements and hence can be relied upon.</i></p>

Consultation area	Supportive %	Not supportive %	Other/ no view %	Comments
<p>7 Should FE colleges no longer be required to retender their internal audit service provision and financial statements audit provision every five years?</p>	75	23	2	<p>This proposal was generally supported. Many of the responses that were not supportive expressed doubts whether FE colleges could achieve value for money without this requirement.</p> <p><i>The requirement for FE colleges to retender their internal audit service provision and financial statements audit provision every five years is removed from the code. FE colleges will have their own procurement policies for services, including audit and these are not affected by the withdrawal of this requirement. Audit committees, as part of their mandatory terms of reference, do have to monitor the performance of their auditors annually.</i></p>
<p>8 Should FE colleges secure from their audit service providers a rotation of the person responsible for the service, every seven years?</p>	70	24	6	<p>A number of responses supporting the proposal wanted the period of rotation to be reduced from seven years to five years. Of the responses that were not supportive, reservations were expressed about the practicalities of rotating partners at small- and medium-sized audit firms.</p> <p><i>The code incorporates the requirement for a rotation of the person responsible for the FE college audit service, at least every seven years. This change will not be introduced retrospectively. The first of the seven years is 2002/03.</i></p>
<p>9 Should FE colleges be required to inform the LSC of significant changes to their audit service providers?</p>	77	17	6	<p>This was generally supported.</p> <p><i>It has been adopted in the code.</i></p>

Consultation area	Supportive %	Not supportive %	Other/ no view %	Comments
<p>10 Should FE colleges be no longer required to retender for their internal audit and financial statements audit provision in the event of a merger of FE colleges?</p>	81	9	10	<p>This was generally supported.</p> <p><i>The requirement for FE colleges to retender their internal audit and financial statements audit provision in the event of a merger of FE colleges is removed from the code.</i></p>
<p>11 Should the code require governing bodies to approve additional work by FE colleges' internal audit services or financial statements auditors or funding auditors above a minimum value?</p>	78	17	5	<p>Many responses queried what the minimum value should be set at. Alternatives suggested a flat value for all FE colleges ranging from £2,000 to £20,000 or a percentage of audit fee or a percentage of FE college income. A number of responses highlighted the difficulty in the timing of governing body approval as work was often commissioned at short notice.</p> <p><i>The code incorporates a requirement for governing bodies to approve all additional work with a cumulative value over £20,000 in any 12-month period by either the FE colleges' internal audit service or financial statements auditors or funding auditors, with the chair's delegated authority to be used to approve all urgent work. Governing bodies can set a lower limit at their discretion. The audit committee must be informed of all work undertaken by FE college auditors.</i></p>
<p>12 Should the code restrict the nature of additional work that may be performed by FE college internal audit services and financial statements auditors?</p>	41	41	18	<p>This was not widely supported.</p> <p><i>It has not been adopted in the code.</i></p>

Notes

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