

# Supplement A

to Circular 04/07

## Audit

Audit Code of Practice



Learning+Skills Council



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# Audit Code of Practice

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## Section 1: Introduction

### Introduction

1 This Audit Code of Practice (the code) sets out:

- the broad accountability framework in which the Learning and Skills Council and the providers it funds operate (Section 2)
- the mandatory audit requirements on further education colleges that the Learning and Skills Council funds (Section 3)
- the audit requirements on Ufi Ltd, operating through learndirect hubs (paragraph 119, Section 5)
- for information, a summary of the audit arrangements for local authority providers (Section 4) and other funding streams and provider types that the Learning and Skills Council funds (Section 5)
- information on other relevant review and audit activities within and outside the Learning and Skills Council that other providers may be subject to.

2 The code will be of interest to management, governors and auditors of organizations within the post-16 education and training sector that are funded by the Learning and Skills Council (LSC). Within this sector, the LSC primarily funds by value further education (FE), school sixth form, work-based learning (WBL) and adult and community learning (ACL) provision. The LSC funds organizations drawn effectively from across the whole of the economy, including FE colleges, higher education (HE) institutions,

central government bodies, local authorities and voluntary and commercial organizations of very varied sizes and legal forms.

### Further education colleges

3 The requirements of Section 3 of the code form part of the LSC's conditions of funding of FE colleges under its financial memorandum, with effect from 1 August 2004. From that date, the requirements in Section 3 of the code replace those set out in the Interim Audit Code of Practice (the interim code) issued by the LSC in 2003 as Circular 03/04.

### Other providers

4 For all other providers, Sections 2, 4 and 5 of the code summarize the LSC's audit requirements. The LSC's full terms and conditions of funding of other providers, including audit requirements, are formally set out in the LSC's funding agreements (that is, financial memoranda, contracts or grant letters) with these other providers. Other providers should continue to refer to their funding agreements for the LSC's terms and conditions relating to its audit requirements.

### Observance

5 In Section 3 of the code relating to FE colleges, the terms "must" and "will" indicate mandatory requirements included in the code. For ease of reference, mandatory requirements for FE colleges are summarized at Annex A of Supplement B to this Code. Supplement B also includes model documents relevant to FE colleges. FE colleges must adopt these documents, or require their auditors to adopt these documents, in order to comply with the requirements of the code.

6 Sections 4 and 5 of the code are for information and do not set out mandatory requirements for other providers. The LSC's audit requirements of other providers are given in their individual funding agreements with the LSC. Other providers must refer to these funding agreements for the LSC's mandatory audit requirements.

7 The LSC will look for compliance with the mandatory requirements of the code or of funding agreements when considering providers' financial management, governance, internal control and application of LSC funds.

## **Applicability**

8 The code should be read in conjunction with the relevant publications of the Auditing Practices Board and other sources of relevant statute. These are principally the Learning and Skills Act 2000 for all providers and the statutory instrument and articles of government for FE colleges. The code is not intended to be a manual. FE colleges, other providers and their auditors should develop their own management procedures and manuals appropriate for them, taking account of this code.

## **Scope of the code**

9 The code summarizes the LSC's audit requirements for all the providers it funds. It is not intended to cover the audit requirements of any other body. Others also have an interest in audit arrangements at providers. The code includes a brief description of the work of some of these other interested parties, as this work is an important part of the accountability framework within which providers operate.

## Section 2: General Accountability in the Sector

### Introduction

10 The LSC and its providers operate in a complex funding and accountability framework. This part of the code is for information, and sets out the broad context of this framework.

### Government accountability

#### Parliament, the Comptroller and Auditor General and the National Audit Office

11 Parliament's interest is to see that public funds are properly accounted for and used economically, efficiently and effectively by recipients. The comptroller and auditor general (C&AG), who is the head of the National Audit Office (NAO), is the auditor of the LSC's accounts. He has the right to inspect the accounts of any learning provider that receives LSC funding and has the right to carry out examinations of the economy, efficiency and effectiveness with which the LSC or the other providers have used their resources in discharging their functions. The NAO is highly selective in its use of inspection rights: its investigations into economy, efficiency and effectiveness normally involve only a sample of providers.

#### Department for Education and Skills

12 The funds distributed by the LSC to providers are received from the Department for Education and Skills (DfES). The permanent secretary of the DfES is the accounting officer of the DfES and is responsible and accountable to Parliament for the resources made available to the LSC. He has to satisfy himself that proper arrangements are being made within his own department and within the LSC to safeguard public funds. To help provide the DfES's accounting officer with assurance on the LSC's arrangements, the DfES's internal audit division (IAD) may make unaccompanied visits to providers, and undertake such enquiries as they reasonably require.

### Learning and Skills Council

13 The LSC is a non-departmental public body funded by grant-in-aid by the DfES under a financial memorandum. The financial memorandum defines the mandatory terms and conditions under which the Secretary of State for Education and Skills (the Secretary of State) makes funds available to the LSC. These terms and conditions include making the LSC's Chief Executive its accounting officer, with similar responsibilities to the DfES's permanent secretary. Specifically, the LSC's Chief Executive must ensure that providers receiving LSC funds:

- have appropriate arrangements for financial management and accounting
- use the funds in a way consistent with the purposes for which they have been given
- comply with the conditions attached to those funds.

14 The LSC's Chief Executive has arranged to provide himself with assurance in relation to these responsibilities. These arrangements include the work of the LSC's IAD and its Provider Financial Assurance (PFA) Service Centre.

15 The LSC's IAD gives annual assurance to the Chief Executive on the overall adequacy and effectiveness of the LSC's risk management, control and governance processes. Part of the LSC's IAD work will be to review the adequacy and effectiveness of the LSC's PFA Service Centre, as one of the LSC's management controls over risk. As part of its review work, the LSC's IAD may occasionally visit providers, in conjunction with the PFA Service Centre's own review programme.

16 The national LSC and local LSCs have established audit committees, which advise respectively the Chief Executive and local Executive Directors on the scope and objectives of the work of the PFA Service

Centre and its regional teams and on the adequacy and effectiveness of the operation of internal control.

17 The LSC's PFA Service Centre is responsible for assurance on the LSC's funding of providers by:

- formulating the LSC's audit requirements for providers
- receiving, analysing and acting on the results of the work of providers' auditors, where the LSC intends to place reliance upon these results for assurance
- regional PFA teams carrying out direct assurance work on certain providers' internal control and their application of LSC funds: the frequency and extent of the work depends on risk and materiality
- directly reviewing the financial management and governance of FE colleges and other significant providers. These reviews are currently on a four-year cycle. The reviews usually take place in parallel with the work of the Office for Standards in Education and the Adult Learning Inspectorate
- assessing the financial health of all providers (except colleges, which remain the responsibility of the local LSC)
- monitoring the appointment and the quality of the work of auditors appointed by providers under the LSC's requirements.

The code contains numerous references to the PFA Regional Audit Manager. The list of PFA Regional Audit Managers and their contact details are published on the LSC website ([www.lsc.gov.uk/National/Documents/SubjectListing/FundingLearning/ProviderFinance/ProviderFinancialAssurance/Contactdetails.htm](http://www.lsc.gov.uk/National/Documents/SubjectListing/FundingLearning/ProviderFinance/ProviderFinancialAssurance/Contactdetails.htm)).

### **The Learning and Skills Council's funding agreements and its assurance responses**

18 Many of the LSC's current assurance arrangements for its funding of providers are inherited. This inheritance has led to assurance arrangements that are based on one or more of the following:

- the type of providers funded
- the form of funding agreement in use
- the LSC funding stream the provider receives.

19 Under the LSC's financial memorandum with the DfES, the LSC must comply with *Government Accounting* published by HM Treasury. In accordance with *Government Accounting*, the LSC uses three types of funding agreement with its providers. These are grant-in-aid, grant, and contract. Each type of funding agreement itself confers different requirements, through *Government Accounting*, on the LSC to obtain assurance.

20 The LSC gives grant-in-aid to FE colleges under a financial memorandum. Grant-in-aid funding is assumed to be in perpetuity and is not time-limited, although supporting schedules giving the funds payable are renewed annually. The financial memorandum requires the FE college to appoint an accounting officer. The FE college must only use LSC funds for the purposes granted and all FE college funds, from whatever source, must be used with propriety and regularity, as defined in HM Treasury guidance. Where the FE college holds unspent funding, it may not be distributed outside the FE college. The FE college is restricted in its arrangements for borrowing and acquisition and disposal of significant assets. The FE college must have accounting and audit arrangements that conform with central government norms, including an interest in all aspects of internal control. A simplified financial memorandum is also used for the LSC's funding of dance and drama awards at dance and drama schools.



21 The LSC gives grants for specific learning provision. Grants are usually renewed annually, but may be for longer or shorter periods or for the purchase of a specific service. Grant funding confers an interest in the proper use of public funds identical to that for grant-in-aid funding. Depending on the conditions of the grant, unspent funds must be surrendered to the LSC or retained by the provider for future public purposes and in any event not distributed outside the public sector. The terms and conditions of grant agreements are otherwise simpler than a full financial memorandum. The LSC uses various grant agreements with local authorities and independent former external institutions.

22 The LSC contracts for learning provision with learning providers from the public, voluntary and commercial sectors. The larger LSC contracts, for the purchase of work-based learning (WBL) provision, will usually be for three years' funding. The LSC also uses short-term contracts for specific learning provision. Many FE colleges and other public bodies currently have contracts in addition to their financial memorandum or grant agreements. Public sector organizations funded under contract will usually have an overarching requirement given elsewhere to make proper use of public funds, even if this is not explicit in the LSC's contract. Commercial and voluntary organizations funded under contract are not normally restricted in their use of LSC funds, once the LSC is satisfied that the contracted learning provision has occurred and is in accordance with the qualitative and quantitative measures of the contract.

23 Given the funding agreements the LSC is required to use, the LSC may seek assurance from providers in any or all of four main areas: financial statements, use of funds, internal control and application of funds. The LSC may require the provider to submit the following.

- Audited "true and fair view" financial statements and related disclosures, including corporate governance statements. For FE colleges, the annual

financial statements are essential to their dialogue with the LSC on financial health, forecasting, borrowing and capital projects. For all other providers, the LSC will use financial statements in assessing the providers' financial health and other analyses.

- A statement, usually audited, on the provider's proper use of public funds (the "use of funds" statement). Alternatively, the LSC may seek to obtain this assurance through the work of its own appointed auditors or PFA teams. This assurance, on how LSC funds have been spent, is as described in paragraph 20. In the case of FE colleges, this assurance is obtained through the regularity audit performed by the college's own financial statements auditors.
- An audit report on the soundness of the provider's systems of internal control. Alternatively, the LSC may seek to obtain this assurance through the work of its own appointed auditors or the PFA Service Centre. For FE colleges, the scope of this assurance is on risk management, control and governance processes. For other providers, it will normally be specifically on those systems that support the production of funding claims or spending of LSC funds, or both.
- In the case of providers not eligible for plan-led funding, a funding claim, based on the FE college or provider's individual learner records or other statistical return, with an accompanying audit report by the auditors of the provider's financial statements. Alternatively, the LSC may seek to obtain this assurance through the work of its own appointed auditors or the PFA Service Centre. The funding claim and audit report demonstrate that the provider has earned the funds allocated to it under the LSC's funding methodology for that provision.

24 The LSC takes as much assurance as possible from the work of providers' existing auditors. The LSC will normally take such assurance where the auditors have been appointed and quality-controlled in accordance with the requirements of the LSC or another body with a statutory role to secure sound audit arrangements within the public sector (principally the Audit Commission, the NAO or the Higher Education Funding Council for England). Where the LSC cannot ensure the quality of the appointment or the work of providers' existing auditors, it will normally seek to appoint its own auditors. These funding auditors will be either the LSC's PFA Service Centre, or audit firms under contract.

25 The timing of assurances will be brought forward in future years to meet HM Treasury's timetable for placing its audited annual financial statements before Parliament. The new reporting timetable will apply to the LSC's financial year ending 31 March 2006 and is described in more detail in paragraph 74.

### **Providers' accountability to others**

26 Providers are subject to many other reviews, by public and private sector bodies. These reviews may make use of the same information as the LSC, such as the audited financial statements. The LSC will seek to minimize duplication, although the scope and objectives of these reviews are often little related to the LSC's assurance needs and reciprocal or commissioning arrangements are unlikely to be meaningful.

## Section 3: Specific Audit Requirements on Further Education Colleges

### Introduction

27 This section of the code applies to FE colleges and specialist designated institutions. FE colleges receive funding from the LSC through grant-in-aid in accordance with the financial memorandum. The term "FE college" does not include adult education institutions and institutions such as specialist providers or dance and drama schools. These institutions are subject to different arrangements, which are considered elsewhere in this code. The term "corporation" refers to college corporations and governing bodies.

28 The code retains many of the existing requirements on FE colleges. An immediate reason for this is that FE colleges continue to be funded under a financial memorandum that, under HM Treasury guidance, continues to require these audit arrangements. Many of these arrangements represent normal (if not universal) requirements and practice for central government funding across the UK public sector. Similar long-standing arrangements for internal auditing, auditing of financial statements and audit committees exist for HE institutions, central government bodies, local authorities, the NHS and Housing Associations. Use of internal audit services (IAS) and audit committees is increasingly seen as best practice in voluntary and commercial sector organizations.

29 This section of the code sets out audit requirements of FE colleges at length, in contrast with the relatively brief sections on other providers and funding streams. This is acknowledged and is a product of the LSC's effective status as "regulator" of the financial accountability of FE colleges. The other parts of the public sector listed above have their own statutes, codes or equivalent documents, on which the LSC normally relies, setting out their requirements in similar vein. These other

codes are not reproduced here. Providers outside the public sector are subject to Companies Acts or Charity Commission requirements or other regulations, none of which are reproduced here.

### Sources of requirements on further education colleges

#### Further education college articles of government

30 The articles of government for FE colleges require corporations to:

- establish an audit committee to advise on matters relating to the corporation's audit arrangements and systems of internal control. The committee shall consist of at least three persons and may include employees of the corporation (as noted in paragraph 27 above, "corporation" should be taken to mean college corporation or governing body), other than those in senior posts, and shall operate in accordance with any requirements of the LSC (article 5 (5))
- cooperate with any person authorized by the LSC to audit any returns of numbers of learners or claims for financial assistance and give any such person access to any documents or records held by the corporation (article 18, or 17 for sixth form colleges)
- arrange for the examination and evaluation on its behalf of its systems of internal financial control to ensure that they contribute to the proper, economical, efficient and effective use of the corporation's resources (article 19 (1)). The persons appointed are referred to as "internal auditors" (article 19 (2), or article 18 (1) and (2) for sixth form colleges)
- appoint for each financial year a financial statements auditor (or external auditor) (article 20 (3), or article 19 (3) for sixth form colleges)

- not appoint any persons as internal auditors who are appointed as financial statements auditors (article 20 (5), or article 19 (5) for sixth form colleges).

Similar requirements are included in the articles of government for Catholic sixth form colleges.

## Financial memorandum

31 The LSC's financial memorandum with FE colleges is that inherited from Further Education Funding Council (FEFC) Circular 99/48, issued in December 1999, and is in the process of being updated. Under the financial memorandum, the corporation has the following obligations.

- It must ensure that funds are used only in accordance with the Further and Higher Education Act 1992, the financial memorandum, and any other conditions which the LSC may from time to time prescribe (paragraph 9).
- It must ensure that the financial, planning and other management controls, including controls against fraud and theft, applied by the FE college are appropriate and sufficient to safeguard public funds (paragraph 10).
- It must secure the economical, efficient and effective management of all of the FE college's resources and expenditure, capital assets and equipment, and staff so that the investment of public funds in the FE college is not put at risk (paragraph 10).
- It must establish an audit committee. The audit committee must include at least one person, whether a governor or not, with relevant financial or audit expertise (paragraph 10).
- It must require the principal to take personal responsibility for ensuring the proper and effective operation of the

financial, planning and management controls and for effecting the corporation's policies for securing the efficient, economical and effective management of all the FE college's income, assets and expenditure (paragraph 12). As the FE college's accounting officer, the principal may be required to appear before the Committee of Public Accounts of the House of Commons, alongside the Chief Executive of the LSC, on matters relating to the use of funds provided by the LSC (paragraph 14).

- It must arrange the auditing of financial statements and internal audit in accordance with the requirements and guidance of the LSC. In particular, it will not be permissible for FE colleges to appoint the same firm to undertake both internal and financial statements auditing (paragraph 36). The LSC may undertake examination of the FE college's internal financial and management controls and may recommend improvements. These examinations will normally take place as part of the cycle of college inspections (paragraph 37). The books and records of the FE college will be open to inspection by the LSC and by the C&AG. To help in providing an assurance on the adequacy and effectiveness of controls within the FE sector, the DfES's internal auditors may make unaccompanied visits to colleges and undertake such enquiries and review such books and records as they may reasonably require to undertake their work (paragraph 38).
- FE colleges shall report all significant (as defined in the Audit Code of Practice at paragraph 100) cases of fraud or irregularity to the LSC (paragraph 41).

32 The public nature of the corporation's role, its financial accountability through the LSC to Parliament, its stewardship of public funds and not least the good name of the FE college and the interests of its learners, all demand high standards of conduct in the exercise of its functions. The existence of a rigorous framework of audit and internal controls can assist governors in this process.

## Audit committee

### Role

33 The role of the audit committee is advisory. Each FE college must establish an audit committee to advise on the adequacy and effectiveness of the FE college's systems of internal control and its arrangements for risk management, control and governance processes. This advice is primarily formed through a consideration of the work of the FE college's IAS and its financial statements auditor. Guidance on risk management is provided in the LSC's *A Guide to Risk Management in Further Education*, available on the LSC website ([www.lsc.gov.uk/National/Documents/SubjectListing/FundingLearning/ProviderFinance/ProviderFinancialSupport/RM\\_in\\_FE.htm](http://www.lsc.gov.uk/National/Documents/SubjectListing/FundingLearning/ProviderFinance/ProviderFinancialSupport/RM_in_FE.htm)).

34 To establish the role of the audit committee, the corporation must set terms of reference for the audit committee. Minimum terms of reference to be used are detailed in Annex B in Supplement B to this Code. While the corporation may add to these terms of reference, it must not add terms that:

- require the audit committee to adopt an executive role
- require members of the audit committee to offer professional advice to the corporation outside their role as governors; or
- cause the committee to lose its primary focus on the adequacy and effectiveness of the FE college's audit arrangements and risk management, control and governance processes.

35 The corporation's approval of the FE college's annual financial statements must be on the recommendation of the audit committee or the finance committee or both committees. Where the corporation approves the financial statements on the recommendation of the finance committee, the audit committee must also receive the financial statements to inform their review of the management letter of the financial statements auditor and consideration of the statement on corporate governance (including assurance that the college has spent its funds with propriety and regularity).

36 The audit committee must have the right of access to obtain all the information it considers necessary from members of the staff and governors, and to consult the IAS and financial statements auditor (and funding auditor if one is appointed) directly.

### Membership and clerking

37 Paragraph 5 of the articles of government and paragraph 10 of the financial memorandum set the requirements for audit committee membership. In order to ensure independence and objectivity, members of the audit committee must not be members of the finance committee (or equivalent) and the chair of the corporation must not be a member of the audit committee.

38 The corporation must determine the membership of the audit committee and the terms on which they are to hold and vacate office. A coopted external member of the audit committee should not normally be appointed as its chair, since the chair has to be able to attend, as of right, all meetings of the corporation. Subject to this, coopted external members should be treated as having equivalent status to full members of the corporation.

39 To maximize the independence of the audit committee, the clerk to the corporation should normally be the clerk to the audit committee. Where the clerk to the corporation

is a senior manager at the FE college or has significant financial responsibility, another individual should act as clerk to the audit committee so as to protect the independence and objectivity of the audit committee.

### **Operation**

40 The audit committee must have the right, whenever it is satisfied that it is appropriate to do so, to go into confidential session and exclude any, or all, participants and observers, except the clerk to the audit committee. When the audit committee exercises this right, the rules relating to quoracy must be observed.

41 The internal auditor must be invited to attend all meetings, as must the financial statements auditor (and funding auditor where one is appointed) where business relevant to them is being discussed. Senior management should be invited to attend audit committee meetings, particularly where their area of responsibility is under discussion.

42 The audit committee must consider all significant audit findings or recommendations but need not be concerned with the more detailed findings unless the audit committee considers this valuable. The corporation, advised by the audit committee, is ultimately responsible for ensuring that management takes appropriate action on those reports that call for it, or for recognizing and accepting the risks of management not taking action.

### **Annual cycle of business**

43 The audit committee must consider a minimum number of items of business each year for it to be able to function effectively. These are set out in Table 1 together with indicative timings.

**Table 1: Minimum cycle of audit committee business**

Current year item of business	Indicative timings (✓)							To recommend to the corporation for approval
	Previous year		Current year			Following year		
	Summer	Autumn	Autumn	Spring	Summer	Autumn	Spring	
1	Appointment and reappointment or dismissal (where applicable) and remuneration of internal auditors.	✓ or autumn term	✓ or summer term					Yes
2	Internal audit needs assessment, strategic plan and annual plan.		✓					Yes
3	Risk management annual report from college management.				✓ or autumn term	✓ or summer term		
4	Appointment and reappointment or dismissal (where applicable) and remuneration of financial statements auditors.				✓ or summer term	✓ or spring term		Yes
5	Interim regularity audit opinion.				✓			
6	Review of performance of the internal audit service and establishment of annual performance indicators for following year.				✓ or autumn term	✓ or summer term		No
7	Funding auditor interim opinion and management letter (where applicable).*						✓.	Yes*
8	Internal audit service annual report.*						✓.	Yes*
9	Financial statements audit management letter.*						✓.	Yes*
10	Annual report of the audit committee.*						✓	Yes*

**Table 1: Minimum cycle of audit committee business (continued)**

Current year item of business	Indicative timings (✓)								To recommend to the corporation for approval
	Previous year	Current year			Following year		Autumn	Spring	
		Summer	Autumn	Spring	Summer	Autumn			
<b>11</b> Recommendation of approval to the corporation of annual financial statements (may be the role of the finance committee or equivalent) including regularity audit opinion.						✓			Yes
<b>12</b> Funding auditor final opinion and management letter (where applicable).								✓	Yes
<b>13</b> Review of performance of the financial statements auditors and establishment of annual performance indicators for the following year.								✓ or summer term	No
<b>14</b> Internal audit reports on reviews and progress update.						Depends on timing of reports			No
						✓	✓		
<b>15</b> Consideration of funding auditor franchise and partnership spot-check reports (where applicable).						Depends on timing of reports			No
						✓	✓		

**Notes to Table 1**

\* Corporations must have all of these reports (items 7, 8, 9 and 10) available before approving the financial statements and the statements included therein on corporate governance, responsibilities of members of the corporation and the system of internal control. The corporation must approve the annual financial statements to meet LSC deadlines.

- Items 7, 8 and 9 may be deferred until the spring term, but see comment above.



## Internal audit service

44 Both the articles of government and the financial memorandum require the corporation of each FE college to establish an internal audit service (IAS).

45 Parts of the code are common to IASs and financial statements auditors. These parts are dealt with at paragraphs 81 to 104 of the code. The IAS must comply with the requirements of the code.

### Standards

46 The operation and conduct of the FE college IAS must comply with the standards of internal audit, which have been promulgated by HM Treasury and included in Government Internal Audit Standards (GIAS). These standards are available at the HM Treasury website ([www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)) and are supplemented by good practice guides. The major requirements of these standards as applied to the internal audit of FE colleges are detailed below in paragraphs 49 to 66.

### Role

47 Internal audit is defined in the GIAS as being "an independent and objective appraisal service within an organization.

- "The IAS primarily provides an independent and objective opinion to the corporation on risk management, control and governance processes, by measuring and evaluating their effectiveness in achieving the organization's agreed objectives. In addition, internal audit's findings and recommendations are beneficial to line management in the audited areas. Risk management, control and governance comprise the policies, procedures and operations established to ensure the achievement of objectives, the appropriate assessment of risk, the reliability of internal and external reporting and accountability

processes, compliance with applicable laws and regulations, and compliance with the behavioural and ethical standards set for the organisation.

- "Internal audit also provides an independent and objective consultancy service specifically to help line management improve the organization's risk management, control and governance. The service applies the professional skills of internal audit through a systematic and disciplined evaluation of the policies, procedures and operations that management put in place to ensure the achievement of the organization's objectives, and through recommendations for improvement. Such consultancy work contributes to the opinion which internal audit provides on risk management, control and governance."

48 The introduction and maintenance of risk management and control processes in FE colleges is a management function. The IAS cannot provide any guarantee against material errors, loss or fraud. The IAS can play a valuable role in helping management to improve risk management, control and governance processes and so reduce the potential effects of any significant risks faced by the FE college.

### Scope of internal audit service

49 The IAS must have formal terms of reference, agreed by the corporation on the recommendation of the audit committee. These must include the terms of reference set out in Annex D to Supplement B. FE colleges may accept other terms and conditions of business but these must not compromise or conflict with the terms of reference given at Annex D.

50 While the LSC does not specify what level of coverage of learner numbers systems college internal auditors should adopt, colleges will wish to ensure that there is appropriate

coverage of learner numbers systems by their internal auditors, or that they have some alternative form of assurance in place over their learner number systems. Colleges may to appoint additional audit or other consultancy work to this end. Where this has taken place, colleges should encourage internal auditors to rely on consultancy work.

Learner numbers systems are major systems in most colleges and will be the basis of monitoring plans and in that respect will be fundamental to the trust relationship.

51 Each FE college must devote sufficient resources to the IAS, taking into account the advice given by the head of the IAS. If the head of the IAS or the audit committee considers the level of audit resources limits the scope of the IAS or prejudices the ability of the IAS to deliver a service consistent with the definition of internal auditing, they must draw this matter to the attention of the corporation. Where agreement cannot be reached on the level of IAS resources, the FE college must report this to the LSC's PFA Regional Audit Manager.

### **Independence**

52 The IAS must be sufficiently independent of the activities it audits to allow auditors to form impartial and effective professional judgements and recommendations. The IAS must be separate from FE college management, even if provided in-house, and without any executive, management or operational responsibilities outside the IAS.

53 Individual internal auditors must not be assigned to assurance work in areas where they have had an executive or other involvement for at least two years after such involvement.

### **Relationships with management, other auditors and other review bodies**

54 The head of the IAS must coordinate IAS plans and activities with FE college managers, financial statements auditors and funding auditors (where appointed) to ensure the most

effective audit cooperation is achieved and duplication of effort is minimized. The IAS must offer the financial statements auditors the opportunity to place reliance on their work, provided this does not prejudice the IAS's independence.

### **Staffing, training and development**

55 The IAS must demonstrate compliance with the four principles of the Code of Ethics for Internal Auditors set out in the GIAS. The principles cover integrity, objectivity, competency and confidentiality.

56 The IAS must be appropriately staffed in terms of numbers, grades, qualification levels and experience to fulfil its objectives in accordance with the GIAS. All internal auditors must be properly trained to carry out their responsibilities and must undertake a programme of continuing professional development. The head of the IAS must either hold the Government Internal Audit Certificate (GIAC) or be able to demonstrate skills, knowledge and experience consistent with the requirements needed for the GIAC, as must the person leading the IAS work.

### **Audit strategy**

57 The head of the IAS must develop and maintain a strategy for providing the corporation with an objective evaluation of the FE college's risk management, control and governance processes, and opinions on their effectiveness.

58 The strategy must be developed to meet the audit needs of the FE college as assessed by the head of the IAS, using the FE college's objectives and risk management as a primary resource. The IAS must develop, as a minimum, a strategic audit approach that over the cycle of the strategy covers all the areas listed in Annex C to Supplement B. FE colleges will be able to commission audit work from their IAS to cover other risk areas identified by the IAS at the planning stage or by the FE college's own risk assessment process.

59 The IAS must prepare annual audit plans designed to implement the audit strategy. The FE college must receive from its IAS timely strategic and annual plans formulated according to the IAS's own priorities. The plans must be approved, before the commencement of work, by the corporation on the recommendation of the audit committee, and must cover the whole year.

### **Management of audit assignments**

60 For each audit assignment, a detailed plan must be prepared. The IAS must seek a sponsor for each assignment. This will normally be the FE college manager with overall responsibility for the area to be audited. Assignment plans must be agreed with the sponsor before any work is done.

61 The IAS must adopt a risk-based systematic approach, as set out in GIAS, for all audit assignments intended to provide an opinion. This approach will enable the IAS to reach the conclusions necessary to form an opinion on the area being reviewed. Such opinions must be clearly stated in assignment reports. Audit opinions can also be derived by the use of supplementary audit techniques and approaches.

62 The IAS must follow up assignments by reviewing the effectiveness of the response of the FE college's management to the findings and recommendations of assignments. The follow-up findings must be reviewed with the sponsor before being reported. The head of the IAS must report to the audit committee any management responses that they judge to be inadequate for the identified risk.

### **Reporting**

63 A written audit report must be issued at the close of each audit assignment. It is the head of the IAS's responsibility to alert the audit committee how far the corporation could be exposed by any shortcomings in the area under review. The degree of control must be related to the risks involved, but it is

management's role to exercise judgement in establishing the balance between risk and control.

64 The IAS must produce an annual report on its opinion of the overall adequacy and effectiveness of the FE college's risk management, control and governance processes, within the scope of its review. The minimum content for an FE college IAS annual report, which must be followed by the IAS, is set out in Annex E to Supplement B. Each FE college must promptly provide a copy of the approved annual IAS report to the LSC's PFA Regional Audit Manager, following its consideration by the audit committee.

### **Quality assurance**

65 The work of the IAS must be controlled at each level of operation to ensure that a continuously effective level of performance, complying with the GIAS, is being maintained. The head of the IAS must develop a quality-assurance programme designed to give assurance that the work of the IAS complies with the GIAS.

66 The head of IAS must make provision for internal quality reviews of the work at the FE college to be undertaken periodically by appropriately experienced or qualified individuals. These reviews must be undertaken at least every other year.

## **Financial statements auditor**

### **Role**

67 The basic objective of the FE college financial statements auditor is to report on the truth and fairness of the income and expenditure for the year, and the financial position of the FE college and any subsidiary companies shown in the financial statements. The financial statements auditor must form an opinion as to whether proper accounting records have been kept and whether the accounts are in agreement with those records, and to state that the accounts have been properly prepared in accordance with the

Statement of Recommended Practice:  
Accounting for Further and Higher  
Education Institutions.

68 The financial statements auditor must also be concerned with the requirements of the LSC to report on the regularity and propriety of transactions. The financial statements auditor must report, in all material respects, whether monies expended out of funds from whatever source administered by the FE college for specific purposes have been properly applied for those purposes and that monies expended out of funds provided by the LSC (and the Higher Education Funding Council for England (HEFCE) if applicable) have been applied in accordance with the financial memorandum (and the funding agreement with HEFCE if applicable) and any other terms and conditions attached to the funding. The financial statements auditor is required to follow the standards set in the audit framework and programme provided by the LSC for the purposes of providing a specific opinion on the regularity and propriety of the college's expenditure. Audit programmes will be published on the LSC website and standards will be monitored through a quality-assurance process.

69 Financial statements auditors must, in their audit report, report on the FE college's compliance with the principles set out in Section 1 of the Combined Code on Corporate Governance issued by the London Stock Exchange. The financial statements auditors are not required to consider whether the principal's statement on the system of internal control covers all risks and controls, nor to form an opinion on the effectiveness of the FE college's corporate governance procedures, nor its risk and control procedures.

### **Letter of engagement**

70 The corporation must appoint the financial statements auditor. The appointment will be subject to annual review and reappointment. The duties of the financial statements auditor must be clearly presented

in an engagement letter. The LSC will be a party to this engagement for that part of the engagement leading to the opinion on colleges' regular and proper use of LSC and other funds (the regularity audit). As a party to the engagement, the LSC is able to set standards for regularity audit work and monitor compliance with those standards. Monitoring compliance will, as far as possible, make use of peer review between firms, as successfully operated by the LSC and firms appointed by the LSC to carry out funding audit. There will be a letter of engagement between the college and the financial statements auditor that will refer to the duty of care owed to the LSC by the auditor in respect of regularity audit. There will be a second letter between the financial statements auditor and the LSC giving a formal duty of care over the regularity audit work at all of their client colleges.

71 The duty of care owed by financial statements auditors in respect of regularity audit is not yet resolved. The model engagement letter with colleges which must be followed by the financial statements auditors is still being developed and will be issued separately. The LSC will review the wording of the letter of engagement every year. FE colleges may accept terms and conditions of business as part of the letter of engagement but these must not compromise or conflict with the terms of reference given in the model engagement letter.

### **Reporting arrangements**

72 The financial statements auditor has no responsibility for auditing or undertaking any detailed work on the FE college's funding claims. Under plan-led funding, the LSC will continue to issue a statement of funds to colleges, for the financial statements auditors to rely on as part of their audit. The arrangements for this are still being developed. Those colleges not eligible for plan-led funding will continue to have a detailed funding audit. Arrangements for

funding audit at colleges not eligible for plan-led funding are described in Annex F to Supplement B.

73 In common with all public bodies, the LSC is subject to HM Treasury's Faster Closure Agenda. This agenda requires the LSC to place its audited annual financial statements before Parliament prior to rising for its summer recess, typically in July each year.

74 The new reporting timetable will apply to the LSC's financial year ending 31 March 2006. The LSC will therefore require regularity auditors to deliver an interim opinion to 31 March 2006 as well as a final report to 31 July 2006. The year 2004/05 will be a transitional year. In summary, the timing of the work would be as shown in Table 2.

**Table 2: Timetable of audit work 2004–05 to 2005–06**

Year	Period	Activity
2004/05	April or May 2005	Regularity audit work takes place on period 1 August 2004 to 31 March 2005.
	Early summer 2005	Audit committee to consider interim regularity audit opinion.
	Mid June 2005	Interim regularity audit opinion submitted to LSC.
	September or October 2005	Financial statements auditors audit college financial statements for the year ended 31 July 2005.
	November or December 2005	College corporation to consider financial statements.
2005/06	April or May 2006	Financial statements auditors visit college to perform interim regularity audit work for the period 1 August to 31 March 2006.
	May or early June	College audit committee to consider interim audit opinion.
	End of May 2006	Interim audit report submitted to the LSC.
	July 2006	LSC lays financial statements before Parliament, based on regularity audit work from 1 April 2005 to 31 July 2005 (work performed as part of financial statements audit) and from 1 August 2005 to 31 March 2006 (interim regularity audit work).
	September or October 2006	Financial statements auditors audit college financial statements for the year ended 31 July 2006 and update regularity audit to 31 July 2006.

### **Audit report**

75 In making their annual report, financial statements auditors must use the wording of the audit report as prescribed by the LSC. The LSC will review the wording of this report each year.

76 Financial statements auditors are reminded that where they are unable to express an unqualified opinion on the FE college's financial statements, or where they wish to use alternative wording to the audit report prescribed by the LSC, they must immediately communicate this to the principal, the chair of the corporation and the chair of the audit committee. They must also inform the Executive Director of the local LSC, or his or her nominee, and the LSC's PFA Regional Audit Manager.

### **Management letter**

77 The FE college must promptly send a copy of the approved management letters of the financial statements auditor, including those arising from interim audits, with the FE college's response, to the LSC's PFA Regional Audit Manager.

### **Eligibility**

78 The criteria required for eligibility as financial statements auditors of FE corporations are set out in paragraph 5b) of Schedule 8 of the Further and Higher Education Act 1992 and included in the list of key definitions at Annex H to Supplement B.

79 A number of financial statements auditors have transferred their business into a limited liability partnership (LLP) formed under the Limited Liability Partnership Act 2000. Under the previous partnership arrangements, the partnership did not have a separate legal status from that of its individual members. The effect of the transfer to an LLP is to establish corporate bodies that constitute a separate legal entity from their members. In practice, this will make no difference to the

FE college as the rights and the liability of the new corporate body will remain the same.

### **Funding auditor**

80 As previously noted in the code, from 2004/05, most colleges will not have a funding audit following the introduction of plan-led funding. Some colleges will not be eligible for plan-led funding from the outset and these colleges will continue to have a funding audit. For these colleges, the funding audit arrangements are set out in Annex F to Supplement B.

### **Areas common to the internal audit service and financial statements auditor**

81 These general principles for auditors are intended to supplement, not replace, those issued by the accountancy bodies. This is necessary because there is a public interest in the use of the LSC's funds and auditors are also concerned with the LSC's requirements.

### **Selection criteria and procedures**

82 On joining the FE sector, or when mergers occur, FE colleges must have in place an IAS and financial statements auditor with effect from the first day of operation of their financial memorandum with the LSC. FE colleges already funded by the LSC have in place both sets of auditors, and can periodically seek to confirm or change their audit service providers. If the audit service provider is changed, the contract with the incoming provider must start on the day after expiry of the contract with the outgoing provider to ensure continuity of provision. Where continuity is not possible, for example, due to the immediate resignation of the incumbent auditors, the FE college must institute interim arrangements before commencing the formal appointment process. Such a period should not normally exceed three months. If the FE college believes that a gap is unavoidable, they must contact their PFA Regional Audit Manager.

83 Each corporation must, in accordance with the financial memorandum with the LSC, appoint an IAS and a financial statements auditor in accordance with the LSC's requirements. Corporations should also follow the college's own financial regulations for making such appointments. The PFA Regional Audit Manager will advise FE colleges on audit appointments in advance of the FE college's selection process, on request. FE colleges must promptly send to the PFA Regional Audit Manager the draft letter of engagement for the audit provider the FE college plans to appoint so that the LSC can ensure it is in accordance with its requirements.

84 An audit service provider proposing to accept the appointment as internal auditor or financial statements auditor must obtain the FE college's permission to communicate with the outgoing auditors. Outgoing auditors must obtain permission from the FE college to discuss its affairs freely with the proposed auditors, and must disclose all information required by the proposed auditors that is relevant to the appointment.

85 Where the IAS is contracted to an external provider, the head of the IAS must be rotated every seven years. The partner responsible for the financial statements audit must also be rotated every seven years. The IAS must annually ensure that appropriate arrangements are in place to guarantee the independence of internal audit.

86 FE colleges must promptly send details to the PFA Regional Audit Manager of a significant change of audit service provider, whether by merger, demerger, takeover or other significant reorganization.

### **Auditors' liability**

87 FE colleges must not appoint a financial statements auditor whose letter of engagement includes any limitation of liability in respect of external audit work. The limitation might be through an explicit clause or by other limitation of liability.

This principle matches that of section 310 of the Companies Act 1985, which prohibits any capping of the auditors' liability in respect of audit opinions given under that Act.

88 For internal audit work, FE colleges can negotiate over any proposal by the IAS to restrict or cap its liability. The corporation must specifically consider and approve any request for a liability restriction. This limit must not be under £1 million.

89 For categories of work other than the certification of financial statements, or internal audit work, FE colleges may negotiate with their audit service provider over any proposal by them to restrict or cap their liability as long as the eventual outcome represents the best value for money and takes into account the wider interests of the FE college, the LSC, the DfES and taxpayers. It should also take into account the risks and likely consequences of any loss suffered as a result of negligence, the effect of the terms of any restriction of liability and the level of professional indemnity held. The corporation must specifically consider and approve any request for a liability restriction.

### **Removal or resignation of auditors**

90 Where the IAS or the financial statements auditor cease to hold office for any reason, they must provide the corporation with either a statement of any circumstances connected with the removal or resignation which they consider should be brought to the corporation's attention, or a statement that there are no such circumstances. The FE college must copy this statement to their PFA Regional Audit Manager without delay.

### **Due professional care**

91 Auditors must exercise due professional care in their work, but the concepts can be explained separately. "Due care" means working with competence and diligence, not infallibility or extraordinary performance. Auditors are not expected to give absolute

assurance. "Professional care" means using audit skills and judgement based upon appropriate experience, training, ability, integrity and objectivity. "Professional care" must be appropriate to the objectives, complexity and materiality of the audit being performed.

92 In exercising professional care, auditors must:

- take reasonable steps to obtain information relevant to the audit: auditors should take into account information from the FE college, the LSC, any changes in legislation and the results of previous audit work
- keep up to date with developments in professional matters
- look out for and take into account any unusual circumstances
- consider audit objectives and plan work to adhere to them
- document the conclusions arising from the planning process, and detail a budget for staff and time
- discuss the main features of the audit with the FE college
- ensure that audits are staffed with suitably qualified and experienced personnel, and that work is properly controlled and reviewed
- ensure that conclusions are adequately supported by reliable evidence. This evidence should be sufficient for an experienced auditor with no previous connection with the audit to ascertain what work was done and how the conclusions were reached
- control costs of audit, and weigh costs and likely benefits
- preserve confidentiality where appropriate.

### **Access**

93 The IAS, the financial statements auditor and (where appointed) the funding auditor must have unrestricted access to all documents, records, assets, personnel and premises and be authorized to obtain such information and explanations as they consider necessary for their work.

94 Each FE college must grant the head of internal audit, the financial statements auditor and (where appointed) the funding auditor, the right of access to the chair of the audit committee and also the right to ask the chair to convene a meeting, if necessary with, or without, other participants. The head of the IAS must have direct access to the principal and to the corporation, normally through the chair of the audit committee.

### **Additional services**

95 The corporation must approve additional services beyond the scope of the auditors' terms of reference, where the cumulative value of this work by any of the audit service providers exceeds £20,000 in any 12-month period. The corporation may choose to adopt a lower threshold for its approval. The audit committee must be informed of all work undertaken by FE college auditors.

96 The corporation and the auditors must ensure that additional services do not compromise the audit service providers' objectivity, independence or ability to achieve audit plans. All work, regardless of value, where there is a possible conflict of interest must be referred to the corporation to enable it to form a view on it.

### **Fraud and irregularity**

97 The financial statements auditor of each FE college has a duty to plan and conduct the audit so that there is a reasonable expectation of detecting material mis-statements in the accounts arising from irregularities, including fraud, or breaches of regulations. Financial statements auditors do not have a duty to search specifically for irregularities and fraud and their audit should not be relied upon to



disclose them. Where the financial statements auditor identifies a serious weakness or an accounting or other control breakdown it must be reported to the principal, the chair of the corporation and the chair of the audit committee without delay.

98 The head of the IAS must issue written procedures to auditors on the action to be taken if they suspect or discover fraud or irregularity and must arrange to be informed by the FE college, as soon as possible, of all suspected or discovered fraud, whether internal or external. The principal and chair of the audit committee must also be informed. Where the audit committee feels there is evidence of irregularity, fraud, corruption or any impropriety, the chair of the audit committee must notify the chair of the corporation, who must raise the matter at the next meeting of the corporation. Where the matter is considered significant, the governors must consider holding a special meeting.

99 All FE colleges must have a written policy on the process to be followed when evidence of potential irregularity, including fraud, corruption or any impropriety, is discovered. The policy must include referral to the audit committee and the commissioning by the audit committee of special investigations by the IAS or others. This must be set out in the FE college's financial regulations or specified separately in a fraud policy statement. The head of the IAS must also be informed so that he or she can consider the adequacy of the relevant controls, evaluate the implication of the fraud on the risk management, control and governance processes and consider making recommendations as appropriate.

100 The FE college, and where appropriate (subject to the requirements of the Proceeds of Crime Act 2003), its funding auditor (if appointed), its financial statements auditor or its IAS must report to the LSC's Chief Executive, and copy to the local LSC's Executive Director, without delay, serious weaknesses, significant frauds, major accounting and other control breakdowns

of which they are aware. A serious weakness would be one which may result in a significant fraud or irregularity, and may include cases of irregularities in expenditure which could lead to suspicions of fraud. Significant fraud is usually where one or more of the following factors are involved.

- The sums of money are in excess of £10,000.
- The particulars of the fraud are novel, unusual or complex.
- There is likely to be great public interest because of the nature of the fraud or the people involved.

101 There may be circumstances that do not fit this definition. In these cases or any others, advice or clarification can be sought from the PFA Regional Audit Manager.

#### **Access to further education colleges and audit working papers**

102 FE colleges must allow the LSC, the DfES's internal auditors and the NAO unrestricted access to all records, information and assets which they consider necessary to fulfil their responsibilities, including, through the FE college's contract with the IAS, IAS working papers and key IAS personnel.

103 Internal audit working papers may be the property of the FE college. The Institute of Chartered Accountants in England and Wales has issued a technical release *Audit 2/98 Access to the Working Papers on Internal and Financial Statements Auditors of FE Colleges* which provides guidance on access to working papers and examples of hold harmless letters. The example hold harmless letters allow the LSC or the financial statements auditors or the FE college's new IAS access to the IAS working papers.

104 The college financial statements auditors must comply with any requests from the LSC, the DfES's internal auditors and the NAO for access to any information which they consider necessary to fulfil their responsibilities. The working papers are the property of the financial statements auditor.

## Section 4: Local Authorities

### Introduction

105 This section sets out, for information, the LSC's general approach to assurance for its funding of learning provision delivered through local authorities and/or local education authorities (LEAs).

106 The LSC's assurance arrangements do not affect the statutory requirements of local authorities in respect of the audit of their financial statements or the internal audit of their internal control. These requirements are not within the LSC's remit. The overarching requirements on local authorities and the role of the Audit Commission are set out at Annex G to Supplement B. The LSC's assurance arrangements are currently organized by funding stream.

### Specific assurance arrangements

107 Local authorities are principally funded by the LSC through grant for the following.

- School sixth form funding: delivered principally through schools maintained by the LEA. Some learning provision for pupils with special educational needs is subcontracted by the LEA to independent schools. The LSC obtains assurance from auditing pupil numbers and qualification aims at a minimal sample of schools annually. The LSC appoints and pays local authority internal auditors to perform the work on the LSC's behalf and report to the LSC. This avoids introducing a further set of auditors of schools.
- Adult and community learning: delivered by local authorities direct, by assignment to adult education institutions or schools maintained by the local authority, or by subcontract to other organizations. The LSC requires LEAs as a condition of grant to make a return to the LSC on their use of LSC adult and community learning funds,

as set out in an annual circular, accompanied by a certificate from the LEA auditors, appointed by the Audit Commission. It is anticipated that this assurance arrangement will be retained as long as local authorities continue to receive block funding from the LSC, under adult and community learning or its possible replacements.

- FE education participation and learner support: delivered principally by LEA-maintained former external institutions. The LSC's assurance arrangements for LEA-maintained former external institutions are set out in annual circulars. The LSC requires all former external institutions to make final funding claims to the LSC: in addition, LEAs are required to provide an audited use of funds statement on behalf of all their former external institutions. The claim and statement on use of funds must be accompanied by a certificate by the auditor appointed by the Audit Commission to audit the accounts of the local authority, as described in Annex G to Supplement B. As with FE colleges, former external institutions are in scope for plan-led funding for 2004/05: approximately half of former external institutions are eligible for plan-led funding for 2004/05. The current rules in respect of funding audit will apply for those FE institutions not eligible for plan-led funding. Former external institutions that are eligible for plan-led funding will not be subject to a funding audit. All LEA-maintained former external institutions are already subject to a regularity audit by the Audit Commission and this will remain for all. Detailed assurance arrangements will be set out in the annual circular for 2004/05.
- Excellence Challenge: under a funding agreement devised by the DfES,

delivered by schools. Assurance arrangements for these funds are under consideration.

108 Local authorities may be funded by the LSC for areas including work-based learning, local initiative and development funding, life skills, workforce development and adult information, advice and guidance (IAG). The LSC's funding of this provision is currently subject to reconciliation, clawback and funding audit. The LSC is exploring how it can bring these areas of funding within the scope of plan-led funding. This learning provision is delivered by LEAs and the institutions maintained by them. Assurance arrangements are described in Section 5 of the code.

## Section 5: Other Providers and Funding Streams

### Introduction

109 This section sets out for information the LSC's general approach to assurance on its funding of learning provision delivered by providers other than FE colleges or local authorities. The LSC's accountability and audit requirements for the learning provision described below are set out in the schedules of the funding agreement for that learning provision. This section considers the following audit arrangements:

- Funding agreement: many of the LSC's funding streams are delivered by a wide range of organizations under funding agreements specific to the funding stream. Some providers have more than one funding agreement.
- Provider type: some providers, other than FE colleges or local authorities, have main funding agreements with the LSC covering a number of funding streams and are subject to a common audit arrangement for these funding streams.

### Audit arrangements led by funding agreement

#### Work-based learning

110 The LSC funds this significant area of learning provision at all types of organization, including commercial organizations, voluntary sector organizations, FE colleges, local authorities and other central government bodies. The LSC's funding agreement for work-based learning (WBL) sets out the returns to the LSC required of providers and evidence that must be retained to support these returns. The LSC is piloting in 2004/05 how it can bring its funding of WBL at FE colleges and local government providers within the scope of plan-led funding for 2005/06 onwards. Once within plan-led funding,

assurance on this LSC funding will be gained from existing regularity audit arrangements.

111 The LSC's PFA Service Centre or its appointed contractors gives assurance on the funding of WBL at all providers. The PFA Service Centre or its appointed contractors review and report to the provider on the soundness of internal control and the application of LSC funds for the purposes intended.

#### Other contract-based funding

112 The LSC funds significant values of learning provision through funding streams including local initiative funding, workforce development, adult IAG and education business links. There are also many other funding streams, with lower financial values, not listed here. Each of these funding streams is subject to a separate funding agreement that each provider receives. Each funding agreement, as for WBL, sets out the audit arrangements required of the provider. The LSC's PFA Service Centre, or its appointed contractors, will give assurance on these funding agreements as for WBL. Where possible, the LSC's PFA Service Centre will plan its work to cover all of a provider's contract-based funding as part of a single review.

113 The LSC is piloting in 2004/05 how it can bring its funding of WBL at FE commercial and voluntary sector providers within the scope of plan-led funding. Doing this will require these providers to be funded under grant and not contract and hence the providers will be required to make regular and proper use of LSC funds. While the LSC funding audit will no longer be required, it will be replaced by a regularity audit that will be new to these providers. The LSC needs to explore with providers the benefits and costs of such a change.

114 The LSC is the final beneficiary of a significant amount of European Social Funding (ESF). It is seeking to match most of this

funding as co-financing of learning provision at both existing and new learning providers. The LSC will seek to perform assurance work on matched ESF as part of its normal assurance work on these providers' other funding. In some cases where the principles of co-financing do not apply, the LSC may require an audit of the costs of ESF provision. The assurance requirements over ESF are those set by the European Commission and the LSC has effectively no influence over these requirements.

## **Audit arrangements led by provider type**

### **Higher education institutions**

115 The LSC has inherited from the FEFC reciprocal arrangements for its funding of HE. Under these arrangements, HEFCE, through its own audit code of practice, requires HE institutions to appoint auditors of their internal control, their financial statements and use of funds for the purposes intended. These auditors report the results of their work to HEFCE. HEFCE's audit service carries out at HE institutions a role parallel to the LSC's PFA teams in examining financial management and governance. This reciprocal arrangements means that, with a few exceptions, neither HEFCE nor the LSC carries out audit work in the institutions and providers that the other party funds. The Chief Executives of HEFCE and the LSC, as their respective accounting officers, exchange annual assurances on the regular and proper use of the other body's funding.

### **Specialist providers**

116 The LSC funds learners with learning difficulties and/or disabilities through individual placements, under schedule and purchase order, at specialist providers. Under these arrangements, the specialist provider's financial statements auditor must provide a statement on the use of LSC funds to the LSC within six months of the end of its financial year. The LSC's assurance

arrangements for this funding have been redeveloped in association with the National Association of Specialist Colleges (NATSPEC) on behalf of its member specialist providers. Where agreement has been reached with individual specialist providers, whether members of NATSPEC or not, for the LSC's PFA Service Centre to perform funding audit at the provider, there will no longer be a requirement for their financial statements auditor to provide a statement on the use of LSC funds.

### **Independent former external institutions**

117 The LSC funds FE participation and related funds at a small number of independent former external institutions. These institutions will until further notice be subject to the same assurance arrangements as LEA-maintained former external institutions. Audit reports on the independent former external institutions' funding claims are, however, provided by the institutions' financial statements auditors.

118 As with FE colleges, former external institutions are in scope for plan-led funding for 2004/05: approximately half of former external institutions are eligible for plan-led funding for 2004/05.

### **Ufi/learndirect hubs**

119 The LSC funds Ufi Ltd (Ufi) through a grant-in-aid relationship from 2004/05. Prior to that, the LSC funded learndirect-branded learning through payments to colleges and through direct payments to some hubs. From 2004/05, the LSC's financial memorandum with Ufi sets out the audit requirements for Ufi. Ufi will put in place its own assurance arrangements upon which the LSC will seek to rely. In common with colleges, Ufi is required to appoint financial statements auditors (who will also deliver regularity audit) and internal auditors. To that end, the requirements set out in Section 3 of the code covering internal audit and financial statements audit will apply to Ufi. The LSC

is currently working with Ufi and discussing the detailed implications with it.

### **Dance and drama schools**

120 The LSC funds a number of dance and drama awards for individual learners at dance and drama schools. The funding is subject to a financial memorandum between the LSC and the dance and drama schools. Under the financial memorandum, the dance and drama school's financial statements auditor is required to report to the LSC within five months of the end of the dance and drama school's financial year-end on:

- the accuracy of data returns
- compliance with the requirements of the Education (Grant) (Dance and Drama) (England) Regulations 2001.

### **Central government bodies**

121 The LSC funds a number of central government bodies, mainly for WBL. The LSC will be exploring whether reciprocal assurance arrangements can be established for this funding with the other bodies. Where such arrangements are not established, the LSC's PFA Service Centre will provide assurance. As described in paragraph 23 above, public sector bodies receiving LSC funding under contract will be subject to an overarching requirement set out elsewhere to make proper use of these public funds. The LSC's PFA Service Centre will not review the proper use of public funds by central government bodies receiving WBL funding.

# Notes

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