
26 May 1998

CIRCULAR

**THE
FURTHER
EDUCATION
FUNDING
COUNCIL**

AUDIT CODE OF PRACTICE

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To

Principals of colleges
College external auditors
College internal auditors
Chairs of college governing bodies
Chairs of college audit committees

Circular type

Information

Summary

Reports on the outcome of
consultation. Introduces the Audit
Code of Practice and related
guidance notes

Reference number: 98/15

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98/15

AUDIT CODE OF PRACTICE

INTRODUCTION

1 This circular gives the results of consultation on the draft audit code of practice (Circular 97/30). It introduces the finalised audit code of practice and related guidance notes which are attached as supplements. The code contains the Council's mandatory requirements. The guidance notes offer guidance on good practice in internal and external audit and colleges' management and governance of the auditing process.

2 The code and the related guidance notes supersede Circulars 92/07 and 92/12 and will come into effect from 1 August 1998.

BACKGROUND

3 The financial memorandum between the Council and the Department for Education and Employment (DfEE) requires the Council to issue an audit code of practice. In turn, the Council, through its financial memorandum with colleges, has required colleges to put in place effective audit arrangements.

4 Three bodies have a formal interest in the college's receipt of these funds through the Council. These are parliament, the DfEE, and the Council. In addition, most colleges are also accountable to bodies such as HEFCE, TECs, local authorities and private sector organisations. The code is concerned with colleges' accountability for the safeguarding and use of public funds, through the colleges' system of internal controls. In addition to the requirement in the financial memorandum to issue an audit code of practice, other factors support its issue:

- the work done by the Council's audit service in reviewing internal audit provision in the first cycle has yielded many valuable lessons on good practice, and how this is best organised by colleges
- an update of the *Government Internal Audit Manual* (GIAM) was issued in summer 1996. Under the terms of their engagement, college internal audit services are required to comply with GIAM.

5 On 8 August 1997, the Council published and distributed widely Circular 97/30 and its supplements, which consulted on the draft audit code of practice.

RESPONSES TO CONSULTATION

6 As noted in Circular 97/30, a working party, comprising college representatives and others with an interest in audit, was formed in the development of the code. The members of the working party are listed at annex A to this circular. The working party met on four occasions, including to consider the responses to consultation, and their views have been taken into consideration in finalising the code. The Council thanks the working party for its contribution.

7 One hundred and sixty responses to the circular have been received. One hundred and three were received by the 30 September 1997 deadline. Responses were received from:

- 131 colleges, including governing bodies and audit committees
- 12 accountancy firms
- seven other internal audit providers
- four accountancy bodies
- six other bodies.

8 In addition, the DfEE, HM Treasury and the National Audit Office (NAO) were closely involved during the production of the code. HM Treasury set the policy for audit across central government, and the DfEE, as the Council's sponsor body, have an interest in how it discharges its responsibilities.

9 Many colleges and internal and external auditors had considered the code in detail and provided in-depth responses that had been discussed at governing body meetings and with senior managers. The Council thanks respondents who contributed in this way. The code has been amended to reflect the majority of comments received, as appropriate. A summary of the main areas in which comments were received is attached at annex B.

CODE OF PRACTICE

10 The code of practice is presented as:

- an overview of accountability within the further education sector. This explains the relationship between the roles of the various sets of auditors who visit colleges

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- requirements in respect of college audit committees, internal audit service providers and external audit providers and arrangements common to both internal and external audit
 - a series of guidance notes which provide further detail and good practice, which should be read in conjunction with the code. These cover audit committees, internal audit, external audit and areas common to internal and external audit
 - annexes contained in the guidance notes which are reference material to support the text.

The code includes an index which covers the code itself, and all four supplements. The index also contains bibliographic references.

11 The code and guidance notes:

- set out the Council's requirements for college audit committees, internal audit service and external auditors
- provide guidance to governing bodies and management of colleges, to assist them in complying with the Council's requirements
- provide guidance to the internal audit service and external auditors of colleges, which are required by governing bodies under the terms of their engagement to comply with the code
- provide guidance to audit committees, to help them assess the effectiveness of colleges' audit arrangements
- to help those outside the sector to understand the strength of the audit framework within which colleges operate.

12 At the time of writing, there are three areas which have not been finalised, namely access to auditors' working papers, limitation of auditors' liability, and the required assurance on the system of internal control which is given by the internal audit service. Amendments will be made to the code as soon as the three unfinalised matters noted previously have been resolved.

13 Circular 97/22 announced that the terms of reference for the Council's audit service would be reviewed. This has been done and the revised terms of reference are attached at annex C to this circular.

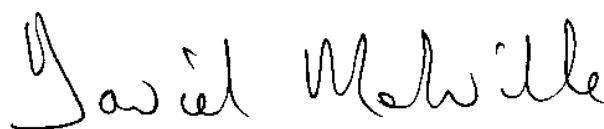
SUPPORT ARRANGEMENTS

14 Seminars on the code and the related guidance notes given in the supplements to this circular are to be provided for interested parties following the issue of this circular. Colleges and auditors will be contacted to invite them to their nearest seminar.

15 Queries on any part of the code may be made by contacting a member of the Council's audit service via regional offices.

16 It will be necessary from time to time for the code to be updated. The Council intends to keep the operation of the code under review and will consult interested parties before making any significant amendments. All amendments will be announced in circulars supplementary to the code and guidance notes. The Council's audit service welcomes comments made to the chief auditor on the code and its operation at any time.

17 A full review of the code will be undertaken by the Council following the end of the Council's current audit cycle. This cycle ends on 31 July 2001.



THE CODE OF PRACTICE WORKING PARTY

Membership

Pauline Tiller	(Chair), Chief auditor, The Further Education Funding Council
Kate Anderson	Education specialist, National Audit Office*
Arthur Baker	Chairman, audit committee, Stafford College
John Brennan	Head of policy development, Association of Colleges
Adrian Brook	National technical manager, Robson Rhodes, chartered accountants
Howard Clark	Chairman, The Sixth Form Colleges Association Limited*
Lesley de Courcy	Director of finance, South Thames College
Jim Haines	Chairman, The Association of Catholic Sixth Form Colleges, St John Rigby Sixth Form College [†]
Heather Hamilton-Herbert	Chair, audit committee, Bournville College of Further Education
Colin Horwath	Partner, KPMG, chartered accountants
John Korzeniewski	Principal, Solihull Sixth Form College
Chris Lauder	Manager, Deloitte and Touche, chartered accountants
Mary Lord	Director, education and training, TEC National Council
Mark Lucas	Manager, Brooking Knowles and Lawrence, chartered accountants
John Mann	Chairman, audit committee, Easton College
Graham Marsden	Partner, Coopers and Lybrand, chartered accountants
Kevin Moloney	The Association of Catholic Sixth Form Colleges, St Brendan's Sixth Form College [†]
Jeff Nash	Assistant county treasurer, Nottinghamshire County Council
Gerard O'Donnell	The Association of Principals of Colleges, West Thames College
Kevin O'Hara	Director of finance, The Sheffield College
Noel Otley	Principal, Uxbridge College
David Pafford	Chairman, Sixth Form Colleges Employers' Forum [§]
Mike Reeves	Director, Wales, employment and further education, National Audit Office
Paul van Rossum	Director of finance, Filton College
Julian Venables	Principal, Carlisle College
Paul Whittle	Chairman, The Association of College Registrars and Administrators
Russell Woodrow	Chairman, The Association of College Management

* *resigned October 1997*

[†] *resigned May 1997*

[‡] *appointed September 1997*

[§] *resigned September 1997*

SUMMARY OF COMMENTS RECEIVED

<i>Comment</i>	<i>Number received</i>	<i>Action by Council</i>
General		
1 The code is prescriptive and will increase the audit burden.	24	The code has been shortened, and contains the Council's mandatory requirements. The guidance notes offer guidance on good practice which colleges, auditors and audit committees may wish to adopt. The guidance notes are not mandatory.
2 Paragraphs 10 and 11 of the draft code are confusing, regarding the meanings of <i>must</i> , <i>should</i> , <i>shall</i> , <i>is required to</i> , and <i>may</i> .	11	This has been clarified in the finalised code.
3 Paragraph 24 to annex B of the draft code requires the notification of any fraud or irregularity to be raised at the governing body meeting following the detection of such a situation. This may not be soon enough.	7	Guidance on this area now states that the chair of the governing body should be notified and consideration should be given to convening a special meeting.
Audit Committee		
1 Requirement for audit committee to produce an annual report to the governing body does not add value and generates more paperwork.	16	The model terms of reference for the audit committee require the audit committee to advise the governing body on the effectiveness of the college's system of internal control. Such a report would assist the committee in carrying out their responsibilities. Model contents of a report are now attached to the relevant guidance note.
2 Co-opted members of audit committee should be eligible to chair that committee.	5	The finalised guidance note on audit committees has been amended to incorporate this.

<i>Comment</i>	<i>Number received</i>	<i>Action by Council</i>
Internal Audit		
1 Paragraph 27 of annex C of the draft code stated that each college must devote sufficient resources to internal audit, as advised by the head of internal audit. Suggested that sentence should read '... having due regard to the advice of the head of internal audit'.	3	The finalised code has been amended to incorporate this.
2 It is not always possible to ensure the continuity of an internal audit service, for example if the internal audit service resign (draft code paragraph 57).	4	Paragraph 53 of the finalised code now states that where continuity is not possible the college should institute interim arrangements prior to commencing the formal appointment process.
3 The requirement for internal audit to give an annual opinion on the adequacy and effectiveness of the whole system of internal control is inappropriate.	19	The financial memorandum between the Council and colleges requires the governing body to ensure that the college has a sound system of internal control. Such an opinion is confirmation that this has occurred. The annual opinion is an HM Treasury requirement and was included as a requirement in Circular 92/12. This requirement has been discussed with HM Treasury which maintains its view.
External Audit		
1 External audit working papers are not the property of the college.	9	This has now been reflected in the code.
2 The Council has no automatic right of access to external audit working papers (draft code paragraph 55).	8	Discussions are taking place with the Institute of Chartered Accountants in England and Wales. Hold harmless letters are being developed to agree conditions of access.
3 Audit managers should be able to attend audit committee meetings in the place of the audit partner (draft code paragraph 40).	3	This has now been reflected in the relevant guidance note.

<i>Comment</i>	<i>Number received</i>	<i>Action by Council</i>
Areas Common to the College Internal Audit Service and External Auditor		
1 The requirement for a full retender when an audit service provider merges is not practical in a world where mergers are becoming a common occurrence (draft code paragraph 53).	4	The finalised code now states that a full retender is only necessary where the auditor undergoes a significant change which affects the provision of the service. This will not necessarily occur when there is a merger.
2 Auditors should be able to restrict their liability.	20	The finalised code gives detailed guidance on this area based on HM Treasury advice. In certain circumstances auditors may be able to restrict their liability on work other than external audit certification work.
3 The numbers of performance indicators for internal audit listed at appendix 1 to annex B of the draft code are excessive.	7	The use of the suggested performance indicators is not mandatory. The appendix has now been amended to state that four to six indicators would be sufficient.

THE FURTHER EDUCATION FUNDING COUNCIL AUDIT SERVICE – TERMS OF REFERENCE

Introduction

1 The Council's audit service is responsible for conducting an independent appraisal of all the Council's activities, financial and otherwise, over a maximum review period of five years. It should provide a service to all levels of management. It is not an extension of, nor a substitute for, good management. The audit service is responsible for giving assurance to the Council's chief executive, as accounting officer, on all financial and other control arrangements. It also informs managers by evaluating and reporting to them on the effectiveness of the controls for which they are responsible.

Scope

2 All the Council's activities fall within the remit of the audit service. The audit service will consider the adequacy of controls necessary to secure propriety, economy, efficiency and effectiveness in all areas. It will seek to confirm that managers have taken the necessary steps to achieve these objectives.

3 The colleges funded by the Council also fall within the scope of the audit service. Rights of access for the audit service are specified in the financial memorandum between the Council and such colleges. The scope of the audit service also covers the use of funds provided to local authorities by the Council in respect of debt charges and other purposes, and in all other institutions funded by the Council including by a further education sector college to an institution outside the sector, to a higher education institution offering schedule 2 provision, to independent colleges providing for students with learning difficulties and to the Further Education Development Agency.

4 It is not within the remit of the audit service to question the appropriateness of policy decisions. However, the audit service is required to examine the management arrangements of the Council and of colleges by which such decisions are made, monitored and reviewed.

5 The audit service will also conduct any special reviews requested by the chief executive or other members of the executive team provided such reviews do not compromise its objectivity, independence or achievement of its agreed plans.

Responsibilities

6 The chief auditor is required to give an annual opinion to the chief executive on the status of internal control within the Council and within colleges for the use of funds made available for which he is responsible as accounting officer. The chief auditor should give an opinion on whether the control arrangements installed and in operation are adequate and properly applied.

7 In order to provide the required assurance the audit service will undertake a programme of work over a cycle approved by the chief executive on the advice of the audit committee, to achieve the following objectives:

- a. to review and appraise the soundness, adequacy and application of controls;
- b. to ascertain the extent to which systems of control ensure compliance with established policies, procedures, and the Council's financial memorandum with the DfEE;
- c. to ascertain the extent to which the assets and interests entrusted to or funded by the Council are properly controlled and safeguarded from losses of all kinds;
- d. to ascertain that accounting and other information is reliable as a basis for the production of accounts and other returns;
- e. to ascertain the integrity and reliability of financial and other information provided to management including that used in decision-making;
- f. to ascertain that systems of control are laid down and operate to achieve the most economic, efficient and effective use of resources.

Standards and Approach

8 The audit service's work will be performed in accordance with appropriate professional auditing practice and will comply with the mandatory standards promulgated by HM Treasury.

9 In achieving its objectives the audit service should:

- a. identify all elements of control systems, highlighting areas of risk, on which it is proposed to place reliance and establish a review cycle;
- b. evaluate those systems, identify inappropriate or inadequate controls and recommend improvements in procedures or practices;
- c. ascertain that those systems of control are laid down and operate to achieve the most economic, efficient and effective use of resources;
- d. draw attention to any apparently uneconomic or otherwise unsatisfactory result flowing from decisions, practices or policies;
- e. evaluate the effectiveness of colleges' financial management, governance, and audit arrangements with a view to placing reliance on them;
- f. recommend, where necessary, improvements in, procedures or practices;
- g. liaise with colleges' internal and external auditors, the audit services of the Welsh Funding Councils and Higher Education Funding Council for England, and the Audit Commission in consultation with the Internal Audit Division of the DfEE.

Independence

10 The audit service has no executive role, nor does it have any responsibility for the development, implementation or operation of systems. It may provide advice, however, on control and related matters, subject to the need to maintain objectivity and to resource constraints. It is the responsibility of the chief executive, on the advice of the chief auditor and the audit committee, to decide the level of audit coverage, having regard to the exposure faced. The audit service will provide the service required by the chief executive while ensuring that its prime responsibility of providing assurance on internal control is not in any way undermined.

11 The audit committee will advise the chief executive on all matters concerning internal control. Within colleges and the Council, responsibility for internal control rests fully with governing bodies and management which should ensure that appropriate and adequate arrangements exist without reliance on the Council's audit service. In

order to preserve the objectivity and impartiality of the audit service's professional judgements, responsibility for implementing audit recommendations rests with management. Similar responsibilities and arrangements should also exist in all colleges receiving funds from the Council.

Access

12 The audit service has rights of access to the Council, colleges and their auditors and all other institutions funded by the Council; personnel, data, documents, records, accounts, information, assets and papers which it considers necessary to fulfil its responsibilities. Rights of access to colleges and their auditors are set out in the Council's financial memorandum with colleges.

Reporting

13 The chief auditor has a direct right of access to the chief executive and the chair of the audit committee. The chief auditor should submit an audit needs assessment, a strategic audit plan, an annual audit plan and an annual report to the chief executive for approval following consultation with the chief inspector and consideration by the audit committee.

14 The chief auditor reports to the Council's chief inspector on the day-to-day management of the service. The chief auditor reports audit results to the chief executive and directors within the Council, and to principals of colleges, as appropriate. The chief auditor will keep the Council's chief inspector informed of audit results and draw the attention of the chief executive to significant findings or recommendations.

15 The audit service will produce its draft reports, usually within six weeks of completion of each audit, giving an opinion on the area reviewed and making recommendations where appropriate. Draft internal audit reports are sent to the relevant director(s) for that system plus Council colleagues identified as responsible for the implementation of recommendations. Draft reports on colleges are provided to the college principal, the Council's chief executive, other members of the executive team and appropriate colleagues. They may be copied to the audit committees of the Council or colleges if appropriate. Recipients of draft reports will be required to respond, usually within six weeks of issue, stating their proposed action with a timed plan for implementing recommendations.

16 Final reports will be produced within one month of an acceptable response. Final internal audit reports are sent to the chief executive, other members of the executive team and the audit committee. Final college reports are sent to all recipients of the draft plus the chair of the college audit committee and the chair of governors. Material recommendations will usually be followed up some six to 12 months later. In addition, the audit committee will monitor the implementation of audit recommendations.

17 The Council's inspectorate and audit service work closely together to assess management and governance on college inspections, jointly considering evidence and participating in grading meetings. To meet HM Treasury's mandatory standards related to independence and reporting, the chief auditor has the right of final decision as to what goes into the published inspection reports as the audit summary.

18 Good practice gathered by the audit service should be disseminated to the sector. The main vehicle for this will be the audit code of practice. This reflects the wealth of evidence gathered by the audit service on best practice.

19 The audit service's annual report to the chief executive and the audit committee shall include:

- a. a statement of the extent to which the chief executive can rely on the internal control system of the Council and those of colleges;
- b. an analysis of common or significant weaknesses arising;
- c. a comparison of activity during the year with that planned, placed in the context of the overall audit need;
- d. details of any major audit findings where action appears to be desirable but has not been taken and which thus needs to be brought to the chief executive's attention;
- e. the extent of achievement of any objectives (including targeted performance indicators) which may have been agreed for internal audit.

Liaison

20 The audit service will, as appropriate, provide information to and ensure liaison with Council regional teams in support of the regional review process.

21 The audit service will liaise with the National Audit Office, colleges' internal and external auditors, the Audit Commission, DfEE Internal Audit Unit Division and the audit services of the Welsh Funding Councils and the HEFCE to improve the level of service it provides to the management of the Council and to colleges.

