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CIRCULAR

THE
FURTHER
EDUCATION
FUNDING
COUNCIL

**Audit of 1998-99 Final Funding
Unit Claim and of the 1998-99
Individualised Student Record
Data**

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To

Principals of colleges
Chairs of audit committees or the
equivalent in external institutions
Heads of higher education
institutions receiving Council funds
Heads of external institutions
Heads of specialist designated
institutions
Chief education officers
Local authority chief finance
officers
External auditors of colleges,
higher education institutions and
specialist designated institutions
External auditors of external
institutions (via heads of external
institutions)

Circular type

Guidance and request for audit
reports

Summary

Guidance to heads of institutions
and audit committee chairs
receiving Council funds in 1998-99
and to external auditors
undertaking audits of 1998-99
final funding unit claims and
student number returns. Includes
guidance on in-year audit checks
for 1999-2000. Audit reports
requested by 4 February 2000.

Reference number: 99/43

Enquiries: Funding and statistics
support desk 01203 863224
Website www.fefc.ac.uk

99/43

Audit of 1998-99 Final Funding Unit Claim and of the 1998-99 Individualised Student Record Data

Introduction

1 This circular and supplements contain information and guidance to help institutions and external auditors satisfy the Council's requirement for the audit of final funding unit claims for 1998-99.

2 To facilitate planning for 1999-2000 and 2000-01, this circular and its supplements, together with Circular 99/01 describing the tariff, represent the major audit instruments to be used by institutions and their external auditors. It is intended that any future amendments, including any relating to new external audit contracting arrangements will be provided as supplements to this circular.

3 Institutions are asked to pass the second copy of this circular and supplements to their external auditor.

Background

4 This guidance takes account of the reports prepared by FEFC and the National Audit Office (NAO) into the alleged irregularities at Halton College. It is written in the light of the thirty-seventh report of the Committee of Public Accounts (PAC). It also takes note of the reviews of external audit work by the Council's audit service on colleges' final funding unit claims and comments received from members of the audit of student numbers working party. The working party includes representatives of institutions and audit firms, and from April 1999, representatives of the Audit Commission.

Applicability

5 The guidance and information in this circular apply to further education sector colleges, as well as specialist designated institutions and higher education institutions that receive funding from the Council and external institutions. For convenience

the term 'college' is used throughout this circular. Aspects which are specific to particular types of institution are separately identified.

Format

6 This publication is divided into four sections for ease of reference. The circular is designed primarily to provide an overview for colleges' senior management and audit committee. Supplement A contains the detailed audit guidance. Supplement B contains the annexes, including a self-assessment checklist and tables of supporting documentation together with the proforma audit reports. Supplement C contains an expanded glossary of terms. Supplement D contains details of the manual adjustments to be made to the funding programme and the list of potential qualifications to 1998-99 audit reports. This will be sent to colleges and their external auditors later in autumn 1999.

Accountability

Colleges

7 The *Audit Code of Practice*, issued in May 1998, reminds colleges that the responsibilities set out in the financial memorandum with the Council are with the governing body and the principal. The governing body of each college must ensure that there is a sound system of internal control within the college. The public nature of the governing body's role, its financial accountability through the Council to parliament, its stewardship of public funds, and not least the good name of the college and the interests of its students, 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 senior management and governors in this process.

8 The college principal is personally responsible for ensuring the proper and effective operation of these controls and may be required to appear before the Committee of Public Accounts of the House of Commons (PAC), alongside the chief executive of the Council, on matters relating to the funds paid by the Council to the college. The principal, or the equivalent postholder in other institutions, is responsible for signing off funding claims as eligible for Council funding.

External institutions

9 In external institutions, there is no less a need for effective systems and controls to be in operation, but the arrangements whereby they are monitored will be dependent, for example, on whether there is an audit committee, whether the institution is local education authority (LEA) maintained and, if so, the LEA's associated systems, and the proportion of an institution's functions supported by Council funding.

Higher education institutions

10 There are similar arrangements for the accountability of senior postholders and the governing body in higher education (HE) institutions. These are set out in the Higher Education Council for England (HEFCE) *Audit Code of Practice*, and its financial memorandum with HE institutions.

Assessing Risk

11 As encouraged by Circular 99/01, colleges should contact the Council where questions arise in relation to Council guidance, especially where new and/or possibly contentious modes of delivery are involved. It has become clear that certain types of provision carry higher risks of not conforming with Council guidance on eligibility. The factors which give rise to higher risk are described below.

12 The key new feature of this circular is the inclusion of a self-assessment checklist (at annex B to supplement B). This is intended to assist colleges and their external auditors to identify provision as high, medium or low risk and subsequently to plan and to focus external audit work. Experience gained from colleges in difficulty indicates that, in many cases, the closer involvement of senior management and the audit committee in ensuring compliance with Council guidance, prior to the work of the external auditors, would have been helpful. Colleges with a proactive approach to audit are more likely to ensure that provision meets the Council's guidelines for funding.

13 The Council requires colleges to adopt a rigorous and ethical approach to the use of public funds. It does not intend to penalise the vast majority of colleges that adopt a conscientious approach for the mistakes of a few highly publicised colleges, by requiring an even more onerous burden of detailed audit work than is necessary. The checks

that are undertaken, however, should be focused on the areas most at risk and be thorough. It follows therefore, that a college with most of its provision in the higher risk categories should arrange for its external auditors to undertake the most rigorous checks.

14 The Council's expectations of the audit of colleges with higher risk provision include:

- a more detailed audit, especially of the identified risk areas
- the involvement of a senior partner of the external audit firm in the planning and supervision of audit arrangements
- the external auditors to report their findings to the audit committee.

15 The Council's audit service carries out reviews of the work of the internal audit service providers of colleges and the work of colleges' external auditors in respect of their audit of the funding unit claim. The results of these reviews are reported to college principals. As outlined in paragraph 2 of supplement A to the *Audit Code of Practice*, the model terms of reference for college audit committees, the Council expects Council audit service reports to be considered by the audit committee. The committee should, if appropriate, advise the governing body of their contents so that all governors are aware of the action management and auditors intend to take to address the weaknesses identified in the reports.

16 If the Council's audit service concludes that the internal audit work is poor for a college with a majority of higher risk provision, then the Council may in future recommend to the governing body that its internal audit provider is changed. If the review of the work of the external auditor on the funding claim were also to receive a poor grade, then the Council may, in future, contract directly with an external auditor to obtain the assurance required. This may encompass detailed forensic audit of previous and/or current funding claims, if appropriate.

Identification of risk factors

17 A college should have a clear view of the risk incurred by the type of provision it makes. Building on the analysis of colleges in difficulty, the Council has identified a series of risk factors which will assist colleges and their external auditors to identify

areas of most concern and to institute appropriate checks. These risk factors have been incorporated into a self-assessment checklist which will enable colleges to assess the provision they make as high, medium or low risk, and to prepare for external audit.

18 The self-assessment checklist which identifies key risk factors for colleges to consider with external auditors is provided at annex B of supplement B to this circular. Colleges with provision in a number of risk areas will be considered to have higher risk provision. The identification of provision in these risk categories is not taken by the Council as in any way evidence of inaccurate claiming; rather that additional checks should be made in these areas.

19 For provision made in 1998-99, the self-assessment checklist should be completed as soon as possible after receipt of this guidance.

Categories of risk

20 The analysis of colleges in difficulty has identified a list of common features which appear to be associated with potentially inaccurate funding unit claims or ineligible provision. Benchmarking data for all colleges has been obtained by ranking colleges separately on each factor. From analysis of the data, the top 40 colleges for each factor may be regarded as being of higher risk for that particular factor. The key risk factors identified together with the benchmarking data are described below.

Factor 1: A rapid percentage growth in units between 1993-94 and 1997-98

21 Colleges which experienced a rapid growth in units of more than 75% between 1993-94 and 1997-98 may have experienced greater difficulty in establishing appropriate quality assurance and management controls over the provision, particularly if this growth is achieved through franchising at a distance. Such rapid growth may leave the college exposed to a greater number of the risk factors defined below.

Factor 2: The percentage of units franchised to other providers

22 The legal basis for franchising is set out in Circular 96/06 *Franchising*. This makes it clear that for franchising to be lawful, the college must be fully in control of the arrangements. In a number of

cases it has become apparent that while a college has formal arrangements in place to meet the control criteria set out in Circular 96/06, in practice the provision was not managed sufficiently closely for the college to be in control. Franchising activity inherently carries more risks. These further increase with the number of units delivered by this type of provision. Colleges with more than 15% of their units attributable to franchising activity should consider this to be a risk factor.

Factor 3: The number of districts from which the institution recruits

23 The chief inspector's national survey, *Collaborative Provision*, published in February 1998, drew attention to the increased risk when franchising takes place at a distance from the main college location. Distance franchising may be measured by the number of districts, defined by local authority boundaries in England, in which a college makes provision. There are some 450 local authority districts in England. Any college which recruits from more than 150 districts should consider this to be a risk factor.

Factor 4: The percentage of recruitment from outside the institution's wider recruitment area in terms of student numbers

24 Distance provision may also be measured by defining a catchment area for a college in terms of the area from which it recruits the bulk of its direct provision students and the out-of-catchment area franchising is, therefore, readily identified. An institution's local recruitment area is defined as the set of local authority districts from which the institution recruits 80% of its student numbers. The wider recruitment area is defined as the set of local authority districts from which the institution recruits 96% of its direct provision. Districts are ranked in terms of direct students each provides; the cumulative total is calculated until 96% of direct provision is covered. The districts ranked within this 96% constitute the college's wider recruitment area. Colleges which recruit more than 10% of their students from outside their wider recruitment area should consider this to be a risk factor. For further information see the Council's website (www.fefc.ac.uk).

Factor 5: The percentage of provision delivered as one-day courses

25 The minimum number of guided learning hours (glh) for a course to be eligible for Council funding is 9. Some courses in further education have traditionally been delivered in a three-session day and therefore have a 9 glh duration. Concerns about the growth of such provision has led to a request for colleges and external auditors to check on the eligibility of courses delivered in one day. Further guidance is provided in annex G to supplement B of this circular. Colleges with more than 10% of their units dedicated to one-day provision should consider this to be a risk factor.

Factor 6: Any provision delivered via the accreditation of prior learning (APL)

26 An analysis of 1997-98 individualised student record (ISR) returns indicates that only 36 colleges in the sector delivered provision via APL. Using the criteria described in paragraph 20 above, this automatically puts this provision in the higher risk category.

Factor 7: The percentage of qualifications undertaken via open and distance learning

27 New provision through innovative modes of delivery is encouraged by the Council to show responsiveness to demand and to widen participation; however, such provision can carry a higher risk of misclaiming if the Council's guidance is not applied prudently and reasonably. Colleges should consider this type of provision to be a risk factor if more than 5% of all their units are attributable to these modes of delivery.

Factor 8: The percentage of qualifications delivered via loadbanded qualifications

28 Where a college delivers a loadbanded qualification then the amount of funding it can claim is dependent upon the number of glh it records in its individualised student record (ISR). In contrast, for individually listed qualifications, which form the majority of qualifications for which the Council funds provision, the amount of funding is determined by the tariff and is not at the discretion of the college. Colleges in which more than 50% of all the qualifications delivered are loadbanded should consider this to be a risk factor.

Factor 9: The percentage of provision delivered as national vocational qualifications

29 National vocational qualifications (NVQs) are competence based and the assessment of competence has to be undertaken in the workplace, or in a simulated workplace environment. This situation can make the application of the Council's glh definition problematic compared to traditional classroom-based delivery. Colleges which deliver more than 25% of total glh as NVQs should consider this to be a risk factor.

Factor 10: The total number of non-English students

30 Colleges should have in place a system for monitoring the number of Scottish, Welsh and Northern Irish students who are not normally eligible to be enrolled on Council-funded provision. The Council's duty is to fund students who are members of the home population of England, and who are resident in England. Further information is provided in paragraphs 91 to 107 of *Funding Guidance 1998-99*. There are three main exceptions:

- colleges close to the Scottish and Welsh borders with a tradition of recruiting from across the border are able to continue this practice, but should not actively seek to increase the proportion of non-English students they enrol
- where the college is a specialist provider and there is not comparable provision in one or more of the home countries and/or where there are reciprocal arrangements in place
- where a small number of students from other home countries are enrolled as part of an arrangement with, for example, an employer who recruits throughout the United Kingdom.

The Council will monitor the number of Scottish, Welsh and Northern Irish students enrolled at a college and will seek further information from colleges with more than 100 such students, unless the college is regarded as close to a national border, in which case the number of such students will be monitored.

31 Colleges should consider their provision against each of the above factors. The level of risk incurred by the provision should be evaluated as follows:

- 5 or more factors identified = higher risk provision
- 3–4 factors identified = medium risk provision
- 0–2 factors identified = lower risk provision.

32 Colleges and their external auditors should undertake additional checks for each risk factor identified. It is expected that generally, the level of risk will equate to the level of audit work required and the subsequent cost this entails. For instance, an institution with provision in several of the risk categories should prepare for in-depth and extensive external audit work with associated higher costs. Sixth form colleges, for example, with provision made for full-time 16–19 year-old students are less likely to be regarded as having higher risk provision. Colleges which do not identify any of the features in the higher risk categories may consider themselves as having lower risk provision and consequently, a lower level of audit will be required.

33 The self-assessment checklist at annex B of supplement B to this circular should be completed and signed by the principal or head of the institution or equivalent in an external institution or higher education institution. The external auditors should review this document with the college as part of the planning to formulate their workplan and are requested to agree or disagree with the self-assessment of risk in the audit report at annex I of supplement B. If the auditors disagree with the college's assessment of risk, the reasons for this should be detailed in the management letter.

Associated risk factors

34 The audit of student numbers working party identified a number of features applicable to all colleges, which its experience has shown may indicate associated risk factors for which additional data checks may be required. The associated risk factors include:

- key staff changes in an organisation, for example, a change in the management of data collection or management information systems
- a change in management information software

- a history of late data returns
- a changed profile from year to year, for example, a move from full-time to part-time provision
- a shortfall in units identified by the institution at the end of the first term or later in the year which leads to hitherto unplanned franchising arrangements
- franchising through college companies or joint venture companies
- overseas ventures.

35 Experience gained from external institutions in difficulties indicates that a combination of the following features may represent associated risk factors and may indicate that more in-depth audit checks are required for external institutions only:

- an independent external institution
- multiple income streams, including European social fund (ESF)
- Council-funded provision further franchised to other organisations
- multiple sites at a distance from the main site
- an independent external institution with different routes for Council funding for different parts of the organisation; that is, some centres with franchising arrangements and some centres with sponsorship arrangements.

Report on Final Funding Unit Claims Requested by 4 February 2000

36 Each institution is requested to arrange for its external auditor to provide the Council with a report on whether:

- the institution's ISR16 (December 31 1999; 1998-99) return is properly compiled in accordance with guidance issued by the Council, including that relating to the eligibility of students and their provision for Council funding, and has been properly extracted from the records of the institution
- the institution's final claim for funding units for 1998-99 is consistent with the ISR16 return and has been properly compiled in accordance with guidance

issued by the Council, including that relating to manual adjustments to the number of units generated by version 6.2 of the funding program

- whether or not the institution delivered any franchised provision during 1998-99. Where the institution did deliver franchised provision during 1998-99, external auditors should report on their attendance at some of the institution's systematic visits to check on franchised provision during 1998-99. External auditors should also report on whether the institution's arrangements for managing franchised provision satisfy the control criteria and accord with the Council's guidance, particularly in respect of systematic visits, and that no Council funding has transferred from institutions to employers, and on the appropriateness of the institution's arrangements where secondment arrangements were made
- the institution's claim for the additional funds detailed in the audit report is correctly calculated in accordance with the guidance issued by the Council.

37 Audit reports should be made using the form provided in annex I to supplement B to this circular, except for specialist designated institutions where different arrangements apply, as set out in annex J to supplement B to this circular. External auditors of external institutions should provide a copy of their audit report, marked 'For information only', to the sponsoring college and to the head of the institution.

38 Where the audit report is delayed, a letter from the external auditors should be provided by 4 February 2000. This letter should explain the reasons for the delay, the action to be taken and a firm promise date, which should normally be within six weeks of the expected return date.

Qualified reports

39 External auditors should make clear which matters referred to in their audit report have a material impact on the institution's final funding unit claim or the statistical accuracy of the ISR16 return and which do not. Where no material issues are identified in the report, subparagraphs 1(a) or 1(b) of the audit report at annex I to supplement B should be selected.

40 Where a report is qualified under section 1, subparagraphs (e) to (g), the external auditor should provide a further report. This further report should give the reasons for qualification including any amendments to returns.

Management letters

41 The purpose of an external audit management letter is explained in paragraphs 3 to 8 of supplement C to Circular 99/15, the *Audit Code of Practice*.

42 Management letters should not be used to report matters that in the external auditors' judgement constitute serious weaknesses or errors. Such matters should be included as a qualification on the external auditors' report on the final funding unit claim and described fully in the further report. The management letter should make clear how the issues raised in it have been resolved. In particular, any adjustments to the claim arising from issues identified in the management letter should be quantified.

43 Copies of management letters and student number returns, including those arising from any in-year checks, should be forwarded to the appropriate regional office by the external auditor at the same time as the original is sent to the institution. This changes the recipient set out in paragraph 9 to supplement C of the *Audit Code of Practice*. Colleges should send a copy of their reply, where this is separate, to the regional office. Only final versions of such documents should be sent to the Council, not drafts.

44 The Audit Commission has advised the Council that management letters are prepared for the LEA rather than the Council. All matters having a bearing on the final claim for student numbers or ISR returns should be referred to in the audit report.

45 Further guidance will follow in autumn 1999 on the form and content of the management letter arising from the external audit of the final funding unit claim.

Late Data Returns

Colleges

46 At its meeting on 12 May 1999, the Council agreed the following action for colleges with late data returns. It will require, as a condition of funding:

- an internal audit report evaluating the college's management information system
- an action plan demonstrating how deficiencies will be remedied as a matter of urgency
- confirmation from the governing body that it has been informed of the concerns and an undertaking from the governing body that timely and accurate returns will be made in future.

47 Colleges will not be eligible for other initiatives, including capital funds. If insufficient progress is made, colleges concerned may be ineligible for growth funding in the following year. Consideration may be given to providing funding support from the standards fund to such colleges to make sure they can make timely and accurate returns.

External institutions

48 For external institutions with late data returns, the Council will require, as a condition of funding:

- an assurance from the principal or equivalent for independent external institutions, or in the case of LEA-maintained organisations, the chief education officer (CEO), that an internal audit evaluating the institution's management information systems (MIS) will take place
- an action plan demonstrating how deficiencies will be remedied within one financial year will be produced as a matter of urgency and shared with the Council.

49 The institution will not be eligible for initiative funds during this period. If insufficient progress is made, the institution concerned may not be eligible for growth funding in the following year. If returns remain outstanding, the Council may seek to recover funds from the institution. In this case, the Council will seek to secure the provision for students if this affects the adequacy of provision, in discussion with the sponsoring college.

50 In the case of LEA-maintained external institutions, the Audit Commission has requested that the Council keep it informed of institutions with late data returns.

Higher education institutions

51 Discussions are under way with the Higher Education Statistics Agency (HESA) and the HEFCE to facilitate timely returns of final funding unit claims. The Council will take appropriate action in respect of the small number of HE institutions which persistently fail to make accurate and timely returns.

Support Facilities

Seminars for colleges and their external auditors

52 Briefing sessions on the audit guidelines given in supplement A to this circular were provided for external auditors in August and September 1999. Representatives of all firms appointed to act as external auditors for institutions have been invited to their nearest seminar. Similar briefing sessions will be held for institutions in late September and October 1999. In addition, it is intended in autumn 1999 to offer institutions and their external auditors, access to 'surgery' sessions in a number of regional offices not covered by the briefing sessions to enable them to explore specific queries. Further details will be available shortly.

Audit queries

53 External auditors and institutions may make enquiries regarding the ISR, Council software, or the audit of the 1998-99 final funding claim either:

- by sending a fax addressed to the 'funding and statistics support desk' on 01203 863249 labelled 'audit of 1998-99 funding unit claims'; or
- by telephoning the funding and statistics support desk on 01203 863224.

In order to receive a prompt and full response, enquirers are requested, wherever possible, to fax rather than telephone. In certain circumstances, the regional office may be best placed to respond to queries. Contact details for regional offices are given at annex K to supplement B of this circular.

Feedback from colleges and external auditors

54 The Council established the audit of student numbers working party in 1993 to advise it on student number audit issues and is grateful for its

continuing advice. A copy of the working party's terms of reference are attached at annex E to Circular 97/02.

55 External auditors and their institutions are encouraged to comment on the audit process by writing to Jerry O'Shea, clerk to the working party, at the Council's Coventry office.

Audit Return

56 External auditors should send the signed original copy of the audit report and supporting documentation to the regional director at the appropriate regional office to reach the Council by **4 February 2000**. Copies should be provided to colleges, HE institutions and external institutions at the same time.

David Marville

