

**THE
FURTHER
EDUCATION
FUNDING
COUNCIL**

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

Guidelines for institutions
and their external auditors

**This supplement contains essential detailed
guidance to be considered by institutions and the
external auditors in undertaking work to
compile the final funding claim for 1998-99.**

**Supplement A to
Circular 99/43**

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Audit of the 1998-99 Funding Unit Claim and of the 1998-99 ISR Data: Guidelines for Institutions and their External Auditors

Introduction

1 These guidelines outline a programme of work to assist institutions and external auditors in fulfilling the Council's requirement that final 1998-99 funding unit claims and underlying individualised student record (ISR) data returns should be audited. They apply to all institutions in receipt of Council funding in 1998-99 and will carry forward for 1999-2000. Any amendments necessary for years subsequent to 1998-99 are expected to be minimal and institutions will be notified of them in supplements to this main guidance, or the Council's website (www.fefc.ac.uk).

2 In designing and operating controls, institutions should familiarise themselves with these guidelines to ensure the accuracy and validity of their returns. External auditors should bear them in mind as they design and implement testing programmes which would, in their professional judgement, enable them to express an opinion on the validity of institutions' final funding unit claims for 1998-99, ISR16 returns and, where appropriate, arrangements for franchised provision.

Format

3 The annexes and tables of detailed audit guidance, referred to in Circular 99/43 and this supplement, are contained in supplement B. A self-assessment checklist has been prepared to categorise the level of risk attributable to the provision made by the institution. This should be used before the involvement of the external auditors, and can be found at annex B of supplement B. A glossary of terms is provided at supplement C. Details of the manual adjustments, which may be made in 1998-99, and the likely qualifications to the audit report, will be sent to institutions and external auditors shortly.

4 The guidelines refer to other publications by the Council. For ease of reference, a list of these, together with an indication of the guidance each provides, is attached at annex A of supplement B.

Applicability

5 The guidance and information in this supplement apply to further education sector colleges, as well as specialist designated institutions and higher education institutions which receive funding from the Council and from external institutions. In the supplements the term 'institutions' is used throughout to reflect the terminology in the audit reports to be signed by external auditors. Aspects specific to particular types of institution are separately identified.

6 Colleges and their external auditors should ensure that the guidance in Circular 99/43, and in all other relevant Council guidance produced from time to time, is known and understood by all concerned in the planning, delivery, and external audit of provision. This is particularly important for franchised provision. Copies of relevant Council guidance should be made available to each partner, and robust systems should be in place to ensure compliance by the partner and its staff.

Audit Context

7 External auditors are asked to audit the final funding unit claim, together with the ISR data which are returned to the Council. Claims for Council funding are based on data relating to eligible individual students enrolled on Council-funded provision at the college. Each category and aspect of provision which the Council funds is assigned a value of funding units in a tariff, which is given in annex A to *Funding Guidance 1998-99*.

8 Details of the characteristics of students and their learning programmes should be retained by each institution and recorded as computer data. A copy of these data is returned to the Council in the form of the ISR on three occasions:

- ISR12 (1 November 1998; 1998-99): data as at 1 November 1998, returned in December 1998
- ISR14 (31 July 1999; 1998-99): whole year data as at 31 July 1999, returned in early September 1999

- ISR16 (31 December 1999; 1998-99): whole year data as at 31 December 1999 following the year end, returned in early February 2000. This is the ISR14 return updated to include destination and achievement data.

9 A full description of the ISR including all data field definitions is set out in the *Individualised Student Record (ISR) Institution Support Manual 1998-99*. Higher education institutions do not complete the ISR but make similar returns to the Higher Education Statistics Agency (HESA).

10 Some specialist designated institutions do not return ISR data to the Council, or return them for only part of their provision. Other arrangements apply for these institutions, and these are set out in annex J of supplement B.

11 The Council announced in *Council News* No. 46 that it has commissioned a review of the funding arrangements for specialist designated institutions; this is due to be completed for the 1999-2000 funding round. For 1998-99, these institutions have been eligible to apply for widening participation funds and Council-managed development funds.

12 The ISR and the funding program both use codes (held in the qualification aims database distributed by the Council) to identify individual qualifications. This database also holds information from the tariff in *Funding Guidance 1998-99* including:

- the cost-weighting factor applying to that qualification
- an indication of whether the qualification falls within the scope of schedule 2 to the *Further and Higher Education Act 1992*
- the number of entry units and on-programme units available for qualifications individually listed in the tariff.

13 External auditors are expected to be familiar with Circular 99/43 and its supplements, the ISR, the funding program and the qualification aims database in order to carry out the audit.

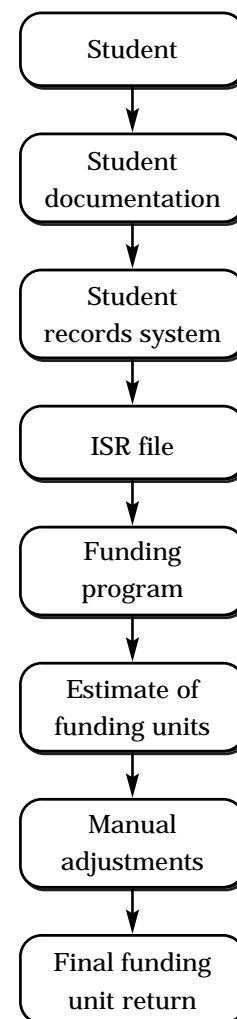
14 Version 6.2 of the funding program and version 12.3 of the qualification aims database should be used for 1998-99 final funding unit claims and their audit. Copies of version 6.2 of the funding program and its accompanying guidance notes have been distributed to all institutions in receipt of Council

funding, and to representatives of all firms known by the Council to be appointed as external auditors of colleges. Copies of version 12.3 of the qualification aims database will be distributed in November 1999.

15 Any issues arising from the use of this software and details of further releases will be published on the Internet information service operated by the Council. The Council's Internet address is www.fefc.ac.uk.

16 The audit trail, which links auditable evidence for individual students to an institution's funding unit claim, includes the institution's student records system, the ISR and the funding program. This is shown in figure 1.

Figure 1. Audit trail



17 Institutions must retain adequate audit evidence in support of their final funding unit return for at least six years. This will include the ISR record and its supporting audit trail including,

where appropriate, course literature for particular qualifications. Where significant audit concerns arise in subsequent years, the Council may wish to reopen previous years' final funding unit claims, even where an unqualified audit report has been received.

18 Colleges should refer to the *Audit Code of Practice*, published in May 1998, which describes the responsibilities of the college and its internal and external auditors in the audit process.

19 External auditors are not required by the Council to audit the funding program or the qualification aims database.

Main Stages of the Annual Audit Process for All Institutions

20 The following description of the main stages in the annual audit process has been developed from the arrangements adopted by most external auditors of colleges for 1996-97 and 1997-98. It is provided for information. Decisions regarding the level of work necessary for individual institutions are a matter for auditors' judgement, and they should take into account the particular circumstances, the identified areas of risk and the areas of particular concern to the Council. The audit report and associated returns are to be received by the Council by 4 February 2000. In cases where this is delayed, external auditors should provide a letter instead, detailing the reasons for the delay, the action to be taken and the expected date for return.

21 For each stage of the audit process, the Council has identified specific issues and areas of work that could be carried out by external auditors. These include, amongst others, areas which experience has shown are particularly complex, which have been the subject of qualifications to previous audit reports or which relate to specific concerns. The lists are not intended to be exhaustive and do not cover all areas of work that auditors will need to undertake or all of the issues that they will need to consider. Whilst the Council expects that all auditors will take them into account in designing their audit programmes, each auditor is expected to use professional judgement to determine the checks that must be completed in order to form and express a professional opinion on whether:

- the institution's ISR16 (December 1999; 1998-99) return is properly compiled in

accordance with guidance issued by the Council, (including that guidance 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 guidance relating to manual adjustments to the number of units generated by the funding program)
- the institution's arrangements for managing franchised provision accord with the Council's guidance and fully satisfy the control criteria
- the institution's claim for the funds detailed in the audit report is properly compiled in accordance with the guidance issued by the Council.

Audit planning

22 Adequate audit planning is essential to ensure that appropriate attention is devoted to different areas of the audit, and that potential problem and risk areas are identified. It is needed also to assist in the proper assignment of work to members of the audit team and in their briefing. A range of documentation has been provided at annexes B, C and D of supplement B to assist with audit planning. However, the checklists and the supporting documentation are not intended to replace auditors' judgement.

Audit staff briefing

23 The reviews performed by the Council's audit service have revealed that planning is not being undertaken in sufficient detail. Particularly relevant findings include the lack of an adequate audit planning meeting with management, the failure to request relevant management reports and undertake analytical review procedures before beginning audit work; and the performance of a limited range of audit testing which omits many of the detailed areas included in Council guidance. For example, auditors often do not question institutions at the planning stage to ensure that their audit programmes include testing of all relevant types of unit claimed and, where necessary, testing in areas which the Council

has identified as presenting difficulties. Auditors should ascertain, before beginning audits, whether claims for funding units have been made in specific areas or whether colleges have particular types of funding. This exercise will facilitate the targeting of audit work, particularly on known areas of difficulty.

24 All members of the audit team must have an understanding of the institution's affairs and, as far as practicable, of the nature and scope of the work they are to carry out before the audit fieldwork starts. Unapproved work may be an inefficient use of resources or may not lead to the necessary assurance being obtained by the auditor. On many of the files reviewed by the Council's audit service, audit staff briefings appear to have concentrated almost exclusively on the audit of the institution's financial statements. Evidence should be kept on file to demonstrate that staff are appropriately briefed before undertaking the audit of funding unit claims and ISR data. The extent of the briefing will obviously depend upon the complexity of the audit. However, briefings should ideally cover such matters as relevant, up-to-date information from the institution, latest Council guidance and the identification of critical audit areas.

Regular use of analytical reports for management, audit and quality assurance

25 Colleges have been provided with a self-assessment checklist at annex B of supplement B. This and any other returns, reports or correspondence with the Council such as that described in paragraph 34 below should be made available to auditors at the planning stage of the audit. For 1998-99, this should be as soon as Circular 99/43 is received.

26 Analytical reports generated from student record systems are valuable tools in the management of institutions, as well as in ensuring the accuracy of the student records and of returns derived from them. Some reports can also be used to assist the audit process, principally by forming part of the institution's ongoing quality assurance of its records, but also by being made available to external auditors at the start of their audit work. To aid their easy and regular production by institutions, a list of the management reports particularly relevant to checks on student records has been prepared and made available to software houses and institutions that have developed their own management information systems. As in

previous years, the Council continues to welcome feedback from institutions and external auditors on the desirability of including these and other reports on the main list. Written comments should be sent to Jerry O'Shea, clerk to the audit of student numbers working party, at the Council's Coventry office on 01203 863115.

27 The list of management reports has been updated in consultation with the audit of student numbers working party, which includes representatives of colleges and audit firms, including, from April 1999, the Audit Commission. It includes reports which could be expected to be generated as part of good management practice, and which are considered essential for the audit. Greater efficiency in the audit may be achieved if these and/or other reports are available at the start of the audit.

28 Auditors should undertake detailed analytical review work at or before the start of the audit. This is likely to include the comparison of various funding unit returns, over time and against forecasts and national norms, in order to identify changes in profile or provision at the college. The results of this review should be used to direct detailed audit testing to areas of audit risk, known difficulty and Council concern.

Evaluation of management controls and student records systems

29 Auditors should make clear the results of their assessment of the management controls and student records system. Reliance, or otherwise, on internal audit is often not documented; nor is the extent to which this affects the approach adopted. Auditors should ensure that the link between their review of the work of the internal auditors and/or their own systems review, and the resulting programme of substantive testing is made clear on file. It should also be appropriately reported to college management and the audit committee. It is important that there is full documentation of any modification in the nature, timing and extent of procedures performed by the auditors, which results from their assessment of the internal audit function or their own systems review.

Scope of the audit

30 In many instances, auditors are only undertaking basic testing of the data, and there is

little evidence that any consideration is being given to the more detailed areas specified in the guidance as meriting auditors' attention. The Council appreciates that, at many institutions, some or all of these detailed areas may not be applicable.

However, there is often little evidence on file that they have been considered by auditors' analytical review or audit programmes. Analytical review and comprehensive audit programmes are an essential factor in demonstrating that all areas have been considered.

31 In some areas of the guidance, the most efficient approach to testing may be to challenge the institution's management on how they ensure that claims for funding units are correctly stated. Management will find their response easier if they complete, in advance of the audit, the self-assessment checklist set out at annex B of supplement B. If satisfactory answers are not forthcoming, auditors will need to devise appropriate substantive tests in order to satisfy themselves that funding claims are not misstated. In some cases this substantive testing may involve contacting directly a significant sample of students and staff involved in the provision.

Sampling

32 On many of the audit files reviewed by the audit service, there is no evidence in the working papers as to the rationale for the selection of sample sizes. It is therefore difficult to see how auditors have determined their sample sizes in order to ensure that audit coverage is adequate and conclusions soundly based. Auditors should include on file adequate evidence of their rationale. Guidance on the action which should be taken when errors are identified in samples is given in paragraphs 83 and 101 below. Colleges and their auditors are invited to contact the funding team on 01203 863115 where further guidance is required.

Completeness of the data

33 Auditors are reminded that part 1 of the audit report (annex I (colleges) and the appendix to annex J (certain specialist designated institutions) of supplement B to Circular 99/43) requires them to express an opinion on whether 'the institution's ISR16 return is properly compiled in accordance with relevant guidance issued by the Council and properly extracted from the records of the institution'. In performing audit work, auditors may

have to rely on information produced by the institution, for example, listings of franchised students, overseas students or students under the age of 16, before performing focused testing on these and other specific areas of difficulty. Auditors should attempt to verify the completeness of the data provided. This might be achieved by performing 'two-way testing', that is, from the ISR database to institution records and from institution records to the ISR database.

34 In addition, institutions should provide their auditors with a wide range of other supportive data sources. For instance, information in support of the ISR data may be obtained from the following:

- a. the funding agreement between the Council and the institution. In addition to the general conditions of funding described in paragraph 28 of *Funding Guidance 1998-99*, this may include specific conditions relating to the provision made by a particular institution. These might include, for instance, provision for individual students with learning difficulties and/or disabilities. In certain circumstances, the Council may not wish its funds to be used by an institution for a specific purpose, for example, to develop provision outside its local catchment areas where such provision is already made. It may therefore include a specific condition of funding in an institution's funding agreement;
- b. the ADDCP returns made in November 1996, 1997, 1998 and 1999 by colleges detailing, for each franchise partner, the student numbers, units and location for the delivery of provision. (See the glossary in supplement C of Circular 99/43 for an explanation of ADDCP returns.) In each year, the information relates to work undertaken in the previous year and forecasts the pattern of delivery expected in the current year. For 1998-99, the details should link to the ISR and the colleges' register of franchise partners. Comparison of these returns between years and with the ISR will provide useful information on the scale of the provision and will assist in the identification of any trends such as the move from franchised to direct provision. It will also assist auditors in planning their programme of testing of franchise arrangements. The requirement to complete the ADDCP will extend to external institutions and higher education institutions in

November 1999. It is a condition of funding for these institutions that franchising is only entered into in exceptional circumstances and after consultation with the Council. It will also include a requirement for colleges to notify the Council of other arrangements with third party companies;

- c. the regional review letter from the regional director received three times a year by institutions. This details any concerns identified by the regional team at their regular meetings. Details of the regional review process are described in Circular 98/12;
- d. relevant correspondence with the Council on audit-related issues;
- e. details of any college companies wholly or partly owned by the college and details of any overseas ventures.

35 From the date of Circular 99/43, the Council will require institutions to copy all data returns to the Council to their external auditors. The Council will copy relevant correspondence to the college's external auditor where this is considered appropriate.

Stage 1: In-year checks

36 The attention of institutions and auditors is drawn to the merits of in-year checks (August 1998 to July 1999 and August 1999 to July 2000) as a means of preventing and identifying errors, omissions and inadequacies. External auditors should have planned checks on institutions' systems, and substantive testing should be carried out while provision is taking place and students are present during the teaching year. External auditors' review of relevant sections of Council audit reports, where these have been finalised and reported to college audit committees, and of internal audit reports, will be relevant to this consideration. In addition, institutions and their external auditors should consider undertaking some substantive in-year checks during autumn 1999, while working on their 1998-99 report, and as preparation for their report on the institution's 1999-2000 returns. This may be particularly valuable where provision is seasonal or at a distance from the college.

37 The need for systematic checks by institutions on franchised provision is referred to in *Funding Guidance 1998-99* and Circular 96/06. Additional information is provided in Circular 99/09 issued in

April 1999, and Circular 99/37 issued in August 1999, which further define franchising and secondment arrangements. Auditors' attention is drawn in particular to paragraphs 7 to 12, 25 and 26 of Circular 99/09. The Council expects auditors to undertake systematic in-year checks on franchised provision where it is delivered away from the institution's main premises, and delivered wholly or in part by people who are not members of the teaching staff of the institution. It may not be possible, effective or efficient to subject some aspects of the control criteria to audit check after the end of the 1998-99 teaching year. Auditors should, therefore, have completed checks while provision was taking place.

38 The main elements of the Council's expectations of institutions' checks on franchised provision are listed in table 1 of supplement B. The Council considers such systematic checks by institutions to be essential, and sections 2 and 3 of the audit report at annex I of supplement B relate specifically to them. Auditors were reminded in paragraph 29 of Circular 98/25 that the Council would expect external auditors to be present at some systematic checks on franchised provision in 1998-99.

39 Auditors were asked specifically to include the following as part of their audit programmes in respect of franchised provision during 1998-99. Each of these elements would have involved some audit checks before the end of the 1998-99 teaching year (31 July 1999). Auditors were required to:

- a. satisfy themselves that the controls set out in Circular 96/06, Circular 96/32 and Circular 99/09 were in place and operating for all of the institution's franchise arrangements;
- b. satisfy themselves that the institution's management was making appropriate systematic checks to ensure that students enrolled by franchise partners on their behalf and recorded in the franchisee's records were correctly described in the institution's student record system and were actually receiving the scheduled provision described;
- c. satisfy themselves that no Council funding was transferred from institutions to employers, including via third parties, as part of a franchise arrangement to provide education and training to their employees. Payments to

-
- employers, for example for the use of premises and equipment, would be appropriate;
- d. satisfy themselves, where secondment arrangements had been made, that appropriate legal advice had been obtained and sufficient evidence was available that a contract as described in Circular 96/06 was not required and that the provision was fully in the control of the college;
- e. satisfy themselves that the guided learning hours recorded for loadbanded provision had been correctly calculated in accordance with the Council's guidance contained in *Funding Guidance 1998-99*.

40 The Council regards the amount of franchised provision by an institution in 1998-99 as being significant where it:

- accounts for 5% or more of the total number of units claimed by the institution, or
- involves recruitment from outside the institution's wider recruitment area.

41 Where either of these criteria is met, institutions should have consulted their external auditors while provision was still in progress during the 1998-99 teaching year. A description of the key elements of the Council's expectations of institutions' in-year checks on franchised provision is in table 1 of supplement B and section 5 of table 2.

42 For 1999-2000, auditors may consider it unnecessary to repeat in-year checks themselves where the franchised provision is not considered significant, as defined in paragraph 40 above. It may also be considered unnecessary where the external auditors attended for similar in-year checks in 1998-99 and the arrangements for each franchised provision and the control systems are unchanged, or where internal audit have attended in 1998-99 and found arrangements to be effective.

Stage 2: Systematised and substantive checks on institutions' ISR14 returns and systems

Colleges

43 In order to complete their audit of colleges' financial statements, external auditors of colleges will need to carry out audit work on ISR14 returns (before 30 November 1999 for colleges, autumn 1999 or January 2000 for other institutions).

44 Colleges' audited annual financial statements for 1998-99 should be provided to the Council within five months of the year end. The five-month period ends on 31 December 1999, save for some specialist designated institutions for which the year end does not fall on 31 July. These statements include an estimate of the amount of funding receivable from the Council for the year in question, calculated from the number of funding units claimed by the college.

45 In September 1999 colleges will have available the ISR14 return, but not the ISR16 return on which the final funding unit claim will be based. Colleges are requested to estimate their income from the Council using the ISR14 return plus an estimate of achievement units. Since these represent around 5% or less of total units, and the proportion is unlikely to change substantially from year to year, any estimation error is not expected to be material. As part of the work needed to express an opinion on the financial statements, it will be necessary for auditors to validate this estimate of the funding units claimed by the institution and the student data underlying it.

46 Since the ISR16 return is an update of the ISR14 return to include achievement and destination data, in practice the bulk of the final claim audit work can be done on the ISR14 return. Substantive testing of achievement data, as well as checks on the college's reconciliation of the ISR14 and ISR16 returns and validation of the final claim for funding units, including checks on manual adjustments, are the only elements that cannot be carried out until the ISR16 return has been completed. Auditors should ensure that this work is adequately addressed.

47 Listed in table 2 of supplement B are some areas of audit work that auditors of colleges should be able to complete, on the basis of the ISR14 return, as part of their work in determining their opinion on colleges' financial statements. This list is not comprehensive and should not replace the auditors' judgement.

48 Where the final income receivable for 1998-99, derived from the final funding unit claim for that year, differs from the estimated income shown in the 1998-99 financial statements, an adjustment should be included in the financial statements for 1999-2000. The Council would not expect this difference to be significant enough to justify a prior-year adjustment, other than in exceptional

circumstances, but rather as an adjustment to the income shown for 1999-2000.

Other institutions

49 While it is possible for external auditors of other institutions to complete at this stage some or all of the areas of work listed in table 2, it may be considered to be more cost-effective to complete systems and substantive checks, other than in-year checks, at a later stage, on the basis of the ISR16 or equivalent return, in order to meet the 4 February 2000 deadline.

Stage 3: Completion of audit of final funding unit claim and ISR16

50 It is expected that the ISR16 return will differ from the ISR14 return primarily by the inclusion of achievement and destination data, although other changes may have been made to correct any inaccuracies identified through audit work. Institutions are required to explain any additional, or removed, student records in the reconciliation of the ISR16 and ISR14 returns, as set out in annex I of the *ISR Institution Support Manual 1998-99* and due to be returned to the Council by 4 February 2000.

51 For colleges and other institutions whose external auditors have carried out the majority of their planned audit work through in-year checks and through checks on the ISR14 return, as described in paragraphs 36 to 48 above, audit checks on the ISR16 return will need to include:

- a. substantive testing of achievement and destination data;
- b. validation of the funding units derived by the institution from the ISR16 data, taking account of the Council's guidance on manual adjustments provided in September 1999;
- c. checks that the changes between the ISR14 and ISR16 returns, recorded in the student reconciliation return, are complete, accurate and consistent with the source documentation held by the institution, and that the units generated by the two returns can be reconciled. Auditors should satisfy themselves that the institution can explain the nature of any changes to individual fields between the two returns. Any widespread or systematic changes should be investigated further by the auditors.

52 In other cases, and particularly where external auditors plan to base the majority of their audit work on the ISR16 return, auditors will need to take account of the areas of work listed in table 2, substituting checks on ISR16 for those on ISR14. Audit checks will also need to include:

- substantive testing of achievement data
- validation of the funding units derived by the institution from the ISR16 data, taking account of the Council's guidance on manual adjustments.

53 To assist institutions and auditors in checking the accuracy of ISR data and funding unit claims, some comparative national statistics have been published by the Council. Further details are provided in annex H of supplement B. It should be noted that in September 1998, the Council published performance indicators for colleges derived from audited ISR returns (ISR10; December 1997). These included details of individual institutions and comparative national statistics.

Audit of specific aspects of institutions' 1998-99 funding allocation

Additional 16-18 year-olds in full-time education

54 Following advice from the secretary of state, the Council distributed £20 million to institutions in 1998-99 to secure growth in numbers of 16-18 year-olds in full-time education and to increase participation among this age-group. As external institutions cannot receive Council funds for 16-18 year-old full-time students, they are not eligible for these funds. Colleges were notified in July 1998 of the number of units allocated to them to enable them to increase the numbers of this age-group in their provision.

55 The Council will be shortly be issuing detailed guidance on how it will monitor targeted 16-18 full-time and widening participation growth funds for 1998-99. Monitoring targeted growth is complex, and the Council intends to use relatively generous thresholds before clawback applies in order to take some account of the difficulties of establishing base data from which to work. External auditors should obtain a copy of this forthcoming circular and the 1998-99 final funding allocation, and agree that the appropriate number of additional students and units can be identified on the ISR.

Widening participation

56 Following the secretary of state's advice, additional funds of £30 million were made available in 1998-99 to encourage recruitment of students from those areas which qualify for a widening participation uplift under the Council's approach to identifying areas of deprivation. Only these students are eligible for the additional funds provided for widening participation. It is expected that as part of their substantive testing, auditors should seek to ensure that such students claimed for funding have a postcode relating to areas with a high Department of the Environment, Transport and the Regions (DETR) index of local conditions. Further details are available on the Council's website (www.fefc.ac.uk).

57 Colleges may not vire funds from one growth category to another, although 16-18 year-old students may also be recruited from areas with a widening participation factor. Such students will contribute to:

- meeting the student unit target for 16-18 growth
- meeting the college's overall funding unit target.

This will not contribute to the targeted adult widening participation growth in student numbers or unit target.

58 Institutions were reminded in *Funding Guidance 1998-99*, paragraph 3, page 1, that the additional funds made available by the government are intended to address identified growth in colleges' local communities. In addition, the chief executive confirmed the local priorities guidance in his letter to institutions dated 9 April 1998, supplemented by Circular 99/38 (July 1999). Where a college is claiming additional growth funds on the basis of postcode or other evidence from outside its own locality, it should have evidence of liaison with other Council-funded institutions in those localities. Where this evidence is not available and/or there is evidence of 'predatory trading', the Council may consider such provision ineligible for funding. This may also be the case where the units claimed are not additional but are part of the college's main allocation. The Council would not wish to fund new provision in an area where it is already being made by another college unless there is clear evidence of additional need.

59 The Council will be comparing the out-turn level of widening participation units claimed by colleges with data for previous years. Where the data for 1998-99 are significantly higher than in previous years, the Council may require further audit work to confirm the claim.

Additional funds available to institutions in 1998-99

Additional funding allocation 1998-99

60 David Melville wrote to colleges on 5 March 1999 with details of the £35 million additional funding in 1998-99 to institutions that expect to exceed their funding agreement for this year through increased local provision. External auditors are requested to confirm that where an institution has received these additional funds, they have been used to increase local provision and the institution has not increased the proportion of distant provision it makes. Local priorities are defined in supplement C and in Circular 99/09. Further information is available on the Council's website (www.fefc.ac.uk).

Funding provision for the homeless

61 A widening participation uplift of 9% for 1998-99 may be claimed for the following individuals:

- people living in supported accommodation provided by a registered social landlord (RSL) or housing association (HA) registered with the Housing Corporation, or provided by another non-profit-making organisation in a building owned by an RSL or HA
- people living in supported accommodation provided by a registered charity
- people living in supported accommodation registered with the local authority or National Housing Federation.

62 'Supported accommodation' means foyers, hostels and other forms of managed accommodation providing housing management support to the residents.

63 Where an institution wishes to claim the uplift, it should retain, along with the learning agreement, a copy of the tenancy agreement between the student and the landlord. The institution should have in place mechanisms to ensure that periodic

checks are made on the continuing eligibility of such students, in the same way as it is required to do in support of tuition fee remission units.

Basic skills Easter and summer schools

64 Institutions were informed of their funding allocation to support the provision of basic skills Easter and summer schools in a letter dated 12 February 1999 from the chief executive. The criteria for funding were that:

- the provision should include basic skills (that is literacy, numeracy or English for speakers of other languages (ESOL), usually found in programme area 10) as a substantial part of the student's learning programme
- students should be enrolled on programmes delivered between April 1999 and 1 June to 30 September 1999. The programmes should normally last at least 30 guided learning hours
- the provision should normally be delivered by institutions within their local recruitment area (defined as the area within which 80% of the college's direct provision is made)
- the provision delivered is in excess of the institution's main Council allocation and is eligible for support in 1998-99.

65 The Council would not normally fund school-leavers until the teaching year after they leave school. In practice, the official school leaving date is 26 June 1999, and students leaving on that date would only be eligible for Council funding from 1 August 1999. In the case of the basic skills summer schools, the Council would wish to encourage collaboration with similar arrangements in schools, and is prepared, on an exceptional basis, to allow provision made for these students after 26 June 1999 to be eligible for the funds made available by the government.

66 In accordance with the Council's funding guidance, it is expected that institutions will retain evidence of the initial guidance and assessment of students' basic skills needs, together with evidence of attendance on the course. External auditors should ensure that the student records comply with Council guidance and are accurately recorded on the institution's ISR.

Out-of-school childcare

67 As announced in *Council News* No. 47, the secretary of state allocated £5 million to expand out-of-school childcare in colleges and external institutions in 1998-99. Circular 98/27, *Allocation of Funds for Out-of-school Childcare*, sets out the arrangements for this fund.

68 Annex A to *Funding Guidance 1998-99* provides guidance on the funding units which may be claimed. These are for the following groups of people:

- unemployed people in receipt of jobseeker's allowance (JSA)
- those in receipt of means-tested benefit
- the unwaged dependants of those listed above
- those enrolled in programmes where the primary learning goal is adult basic education (ABE) or ESOL.

69 The audit evidence required is described in paragraphs 139 to 140 of annex A to *Funding Guidance 1998-99*.

Transfer of units between Council-funded institutions

70 Higher education institutions were reminded in Circular 98/25 that the funding agreement with the Council specifically prohibits them from delivering their Council-funded provision by means of a franchise agreement with other Council-funded institutions of any type. In Circular 96/32, the Council extended this restriction to all other Council-funded institutions. *Funding Guidance 1998-99*, paragraph 39, explains that the withdrawal of the demand-led element reduces the scope for institutions to 'trade' units and to incur disproportionate expenditure. In addition, the secretary of state has encouraged institutions to promote more collaborative activity. Institutions were requested to discuss with the appropriate regional director any plans for partnership activity that may involve the transfer of units between institutions which receive funds from the Council. Auditors should expect such institutions to be able to provide documentary evidence that the Council has specifically agreed to any such development.

Data Returns Supporting the Final Funding Unit Claim

All institutions except higher education institutions

71 External auditors should arrange that each institution they are to audit provides them with a copy of:

- the ISR14 return and the associated ISR summary sheet from the Council giving notification of the successful validation of these data. This is if the audit is not to be wholly based on the ISR16 return
- the ISR16 return and the associated ISR summary sheet from the Council giving notification of the successful validation of these data, where this is available. Where ISR16 is returned to the Council only shortly before the audit report, then the ISR validation report may not be available in the college. In such cases the ISR14 validation report is sufficient provided that there are no significant differences in the students included in the ISR14 and ISR16 returns. The summary sheets are not available until after the ISR16 return has been processed by the Council. In a small number of cases the Council has accepted a paper-based ISR return from institutions with fewer than 50 student records
- the reconciliation of ISR16 with ISR14, as requested on page 28 of the ISR institution support manual 1998-99 and due to be returned to the Council. This is if the audit is not to be wholly based on the ISR16 return
- form FINAL CLAIM 99, which shows the 1998-99 final claim for funding units by an institution, to be signed by the head of the institution, and to be returned to the Council
- form FINAL DIFF 99, which gives a reconciliation between the number of funding units claimed on form FINAL CLAIM 99 and the number of funding units generated by the funding program using the ISR16 return, due to be returned to the Council.

72 Institutions are asked to make the ISR returns available to auditors in sufficient time to allow them to return the audit report to the Council by 4 February 2000. The notification from the Council of the successful validation of ISR returns will include a statement of the funding units estimated by the Council from these data, using the funding program. Auditors should ensure that the ISR return they audit is consistent with this estimate of funding units.

Higher education institutions

73 HE institutions do not return the ISR directly to the Council but return student records to HESA. A return equivalent to the ISR is derived from these records and passed to the Council. HE institutions are required to support their final funding unit return with output from the funding program.

74 In some cases HE institutions have created a file from the data returned to HESA, which can be imported into the funding program using the import option for non-ISR data. The Council commends this approach. Others have chosen to enter the data manually into the funding program. In both cases, auditors should arrange for the HE institutions to provide them with access to the funding program and the imported data. Where data have been manually keyed into the funding program, auditors may need to take account of the additional risks associated with keying errors.

75 Where the HE institution has not entered data into the funding program, the Council proposes to provide the institution with reports from the funding program. These will be generated from data returned to HESA and passed to the Council.

76 External auditors should arrange for each HE institution by which they are engaged to provide them with access to:

- the appropriate HESA individualised student record, in place of the ISR
- the data file derived from the HESA data and imported to the funding program, where the HE institution has done this
- reports generated by the funding program.

77 In all cases the Council will compare HE institutions' final funding unit claims with the number of units generated by the funding program from the data returned to HESA. Where this reveals

a significant difference or where other issues have been identified with the HESA data, clarification and, where necessary, details of amendments will be sought from the institution. The external auditor may be asked to confirm the validity of any amendments.

Transfer of Funds for HNCs and HNDs to the HEFCE

78 Colleges were notified in a joint letter dated August 1998 from David Melville and Brian Fender, the chief executive of the Higher Education Funding Council for England, of a transfer of funding from the Council to HEFCE from autumn 1998-99. Further details of the arrangements for the transfer were provided to colleges in David Melville's letter of 28 August 1998. This explained that in 1999-2000, HEFCE's responsibility for funding higher education in further education colleges would cover first and higher degrees, degree level equivalents (which are prescribed), higher national certificates (HNCs), higher national diplomas (HNDs), and other prescribed higher education.

79 In a few isolated cases, the transfer of funds has indicated double funding in previous years from the Council and HEFCE. External auditors are asked to carry out checks to confirm that in 1998-99 students identified on the Higher Education in Further Education Statistical (HEFES) return to HEFCE are also identified as higher education students. Colleges should do this by completing field Q10 of the ISR returned to the Council.

Qualification of Audit Reports

80 External auditors should carry out enough work to avoid qualifying the audit report for reasons of uncertainty alone. The amount of work needed to form such an opinion is a matter for external auditors' judgement, but will be subject to particular scrutiny by the Council's audit service in its sample checks on auditors' working papers.

81 Many auditors are applying financial materiality considerations to the audit of funding unit claims. However, as well as providing valuable support for auditors' work on financial statements, the audit of funding unit claims is also an audit of the data. Auditors are required to certify that data are correctly extracted from the records. Samples selected should be representative of the institution's

provision as a whole and should also take into account the areas of difficulty identified by the Council.

82 In many instances auditors are omitting to include testing on some types of units because their monetary value, in total, does not represent a 'significant amount'. The complete lack of testing in these areas potentially undermines auditors' ability to certify that data are correctly extracted from the institution's records.

83 Similarly, whilst the definition of a few isolated cases is left to the professional judgement of the external auditor, taking account of their assessment of the control environment, this guidance assumes that it is made in terms of the whole population of the institution rather than a specific sample. This is particularly relevant where small samples are used for substantive audit testing. In such cases, where inadequacies are identified in the sample, external auditors will need to consider extending their sample testing in order to assess whether these inadequacies relate to more than a few isolated cases in the population as a whole. The Council audit service's reviews to date have shown that auditors are not always taking this action in response to errors found.

Action Arising from the Audit of Previous Years' Funding Unit Claims and Data

84 The Council will identify in further advice, provided to institutions and their external auditors, its probable response to the main potential qualifications to 1998-99 audit reports. This response is based on the Council's experience of previous audit reports. In summary, the advice will adopt the following actions. Where audit testing shows, and auditors are satisfied by consequent work undertaken by themselves or the institution:

- that inadequate audit evidence has been kept by the institution in a few isolated cases across the whole population of the institution, but where the final funding unit claim, and for colleges their income, have not been materially misstated — auditors would be expected to report the finding in a management letter
- that there are more than a few isolated cases in which inadequate audit evidence

has been kept by the institution — auditors would be expected to qualify their audit report and to do sufficient work to validate the institution's estimate of the number of funding units for which inadequate evidence had been kept. The Council can then determine whether an adjustment to the institution's final funding allocation should be made

- that there are a few isolated errors or omissions in the institution's ISR16 return, which are not expected to affect the calculation of funding units or statistics such as performance indicators — auditors would be expected to report the finding in a management letter
- that there are more than a few isolated errors or omissions in the institution's ISR16 return, which might be expected to affect the calculation of funding units or statistics such as performance indicators — the institution would be expected to return revised ISR16 data and, if necessary, a revised funding unit claim, both of which have been validated by the institution's auditor
- that there are errors in the manual adjustments to the institution's final funding unit claim — the institution would be expected to return a revised funding unit claim that has been validated by its auditors.

85 Where amendments to an institution's funding unit claim are quantified or validated by the external auditor, the Council will review them to determine whether additional clarification or work will be needed, and to determine the scale and timing of appropriate adjustments to payments. Where the audit report indicates that amendments appear to be necessary, but they have not been quantified or validated by the auditor, the Council will ask the institution to undertake further work to establish what data amendments are required, to assess their funding impact and to have any amendments validated by the external auditor.

86 The Council's funding and statistics support desk is available to provide information and advice to institutions and external auditors and to assist external auditors in providing in their audit report

all the information necessary for the Council to act on the final funding unit claim.

Reporting

Form of the audit report

87 With the exception of specialist designated institutions that do not return ISR data to the Council, the Council expects the audit report to be made on the standard form provided at annex I of supplement B to Circular 99/43. There is evidence for 1997-98 returns that some auditors are not returning the report on the standard form. This can lead to delays.

88 The auditors should include with their report the institution's final funding unit claim and a copy of the institution's completed ISR14 or ISR16 summary sheet. The form of audit report to be used for specialist designated institutions that do not return ISR data to the Council is attached at the appendix to annex J of supplement B to Circular 99/43. In all cases the audit report should be returned to the Council before 4 February 2000 by the institution's external auditor.

89 It is essential that the standard audit report sent to the Council is a top copy bearing an original manuscript signature. Where other forms attached to the audit report have been amended by the auditor, a copy bearing the auditor's original manuscript amendments in red ink should be sent to the Council. Photocopies of forms amended by the auditor are not acceptable.

90 External auditors should provide institutions with a copy of their report. External institutions should provide their sponsoring college with a copy of their audit report, clearly marked 'for information only'.

Late data returns

91 At its meeting of 12 May 1999, the Council agreed the conditions of funding which should be attached to the funding agreement of colleges with late data returns. These are detailed in paragraphs 39 and 40 of Circular 99/43, together with the implications for external institutions (paragraphs 41 to 43). Further discussions are taking place with HESA and HEFCE to consider the position for HE institutions which consistently return late data.

92 No institution with outstanding final funding unit claims and/or use of funds reports will be

eligible for initiative funds, including capital funds. They may also be ineligible for growth funding in subsequent years. If returns remain outstanding, the Council may seek to recover funds from the institution.

93 Where the return is delayed, a copy of 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.

Use of subparagraphs 1(a) and 1(b) of the audit report

94 The following guidance applies to the external auditors completing a report in accordance with annex I of supplement B to Circular 99/43.

95 The institution should provide under paragraph 1 of the audit report the institution's own assessment of the risk of its provision in accordance with the self-assessment checklist at annex B of supplement B to Circular 99/43.

96 The external auditor should state at subparagraphs 1(a) or 1(b) whether in agreement with the institution's self-assessment of the risk of its provision. The external auditor's agreement should be based upon the self-assessment checklist at annex B of supplement B to Circular 99/43. External auditors are not expected to undertake detailed analysis to verify the institution's assessment; rather they will rely on their knowledge of the institution and its provision.

Use of subparagraph 1(c) of the audit report

97 Where auditors have carried out an audit programme that takes account of the guidance and information in Circular 99/43 and its supplements and are satisfied that the ISR16 return and the final claim for funding units have been properly compiled and are consistent, and also that all matters identified have been satisfactorily addressed, then an unqualified opinion should be given using subparagraph 1(c) of the audit report.

Use of subparagraph 1(d) of the audit report

98 Where auditors have carried out an audit programme that takes account of the guidance and information in Circular 99/43 and its supplements and have determined that amendments are necessary, either to the paper

forms returned to the Council or to a number of ISR records, the audit opinion should be given using subparagraph 1(d) of the audit report. The amendments are to assure that the ISR16 return and the final claim for funding units have been properly compiled and are consistent, and that all matters identified have been satisfactorily addressed. In addition:

- where the amendments concern the paper forms sent to the Council, they should be made and initialled in red ink by the external auditor on a copy of the form originally returned to the Council, and attached to the report
- where the amendments relate to the ISR, and the number of amended records is small, a printout of the relevant records should be obtained and amendments should be marked on the printout in red ink by the external auditor and attached to the report
- where the amendments relate to the ISR, and the number of amended records is significant, the external auditor should arrange for the institution to make a revised ISR16 return to the Council. The institution should request its external auditors to confirm that the effect of any consequent change in the institution's final funding unit claim, as a result of the amendments, is consistent with the auditor's expectations.

99 The use of subparagraph 1(b) does not constitute a qualification to the audit report.

Use of subparagraphs 1(e), 1(f) and 1(g) of the audit report

100 Where the external auditor is unable to complete the report without qualification for reasons other than just the need for amendments to ISR returns, the audit opinion should be given using subparagraphs 1(e), 1(f) or 1(g) as appropriate. In addition, a separate report should be attached which sets out the reasons for the auditor's concern and any matters where the institution and auditor have not reached agreement. It should include:

- the factual position
- the reasons for the problems

- any action being taken by the institution to address the concerns raised, with the timescales for the action
- an estimate of the extent of any over- or under-statement of funding units in the final claim that has been validated by the external auditor.

101 In order to ensure that qualified claims can be processed efficiently and speedily auditors intending to qualify a report should ensure, where possible, that:

- sufficient work has been carried out to identify the number of units that may be affected using sample sizes of 20%
- sufficient work has been carried out to provide the Council with information that will enable the report to be processed
- where processes and documentary evidence required by the funding guidance were not in place, work should be carried out to identify in detail those systems and procedures that were being operated by the institution. Institutions should ensure that as much work as possible is carried out to quantify identified errors before the report is sent to the Council.

Use of paragraph 2 of the audit report

102 The external auditor should confirm, by deleting as appropriate either subparagraph 2(a) or 2(b), whether the institution delivered any franchised provision during 1998-99 as defined in paragraph 40 of this supplement. Where the institution did deliver franchised provision, external auditors should adopt an equivalent approach to that used for paragraph 1 and paragraph 2 of the audit report. External auditors should include within their opinion all of subsections (i) to (v) given in paragraph 2.

103 Where the institution has delivered franchised provision, the external auditor should confirm by deleting as appropriate either subparagraph 2(c) or 2(d) stating whether they were present at some of the institution's systematic visits to check outward franchising provision during 1998-99, as set out in paragraphs 37 to 39 of this supplement. Where the external auditor was not present, the reasons for this and any other concerns that the external auditor may have should be set out in a separate report accompanying the audit report.

Use of paragraphs 3 and 4 of the audit report

104 External auditors should adopt for paragraphs 3 and 4 of the audit report an equivalent approach to that used for paragraph 1.

Completion of the audit report to be used for specialist designated institutions that do not return ISR data to the Council

105 External auditors of specialist designated institutions that do not return ISR data to the Council should complete the audit report given in the appendix to annex J of supplement B to Circular 99/43. Paragraphs 1 and 2 of the report should be completed in an equivalent way to subparagraphs 1(c) to 1(g) and subparagraphs 4(a) to 4(c) of the audit report at annex I of supplement B to Circular 99/43.

Contact with the Council

106 External auditors of institutions, other than external institutions maintained by local education authorities, are required to consult the Council if they plan to issue a qualification under paragraphs 1(d), 1(e), 1(f), 1(g), 2(d), 2(f), 2(g), 3(b), 3(c), 4(b) and 4(c) of the standard audit report. They should do this before returning their report to the Council. This is to help ensure that the reasons for qualification are consistent across the sector. They should first of all agree with the institution, where possible, the nature of the qualification proposed and then contact the funding team without delay to establish whether the proposed intention to qualify is consistent with the approach of other auditors.

107 External auditors of external institutions maintained by local education authorities should consult the audit support grants team of the Audit Commission where they have any doubts about the qualifications to their audit report. The audit support grants team may be contacted by fax on 0117 979 0552 or by telephone on 0117 975 7861.

108 This is similar to the guidance to external auditors of institutions where they determine that they are unable to express an unqualified opinion on the financial statements of the institution. Auditors who failed to follow this procedure in respect of 1994-95, 1995-96, 1996-97 or 1997-98, have been contacted by the Council. The Council will take a serious view of failure to follow this procedure, and will consider whether such lapses should be reported to institutions which consult the Council's

chief auditor under the selection procedure contained in the *Audit Code of Practice*.

109 External auditors and institutions may make enquiries regarding the ISR, Council software or the audit of 1998-99 funding unit claims:

- by sending a fax 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 asked, wherever possible, to fax rather than telephone.

Management letters

110 External auditors, particularly those of higher education institutions and external institutions not maintained by a local education authority, are reminded that copies of management letters relating to final funding unit claims and student number returns, including those arising from any in-year checks, should be forwarded to the chief auditor via the relevant regional office at the same time as the original goes to the institution. Regional office addresses are at annex K of supplement B to Circular 99/43. Only final versions of management letters should be sent to the Council, not drafts. Where the auditors' recommendations and the institution's reply are separate documents, both should be sent.

The self-assessment checklist

111 Institutions and external auditors are reminded that they are requested to consider the self-assessment checklist provided at annex B of supplement B as part of the planning to formulate their work programme. For 1998-99 provision, the self-assessment checklist should be completed by the college as soon as the audit guidance is received. External auditors are asked to confirm their views on the accuracy or otherwise of the institution's self-assessment in the audit report. If the auditors disagree with the institution's self-assessment, they should detail the reasons in the management letter provided to the institution for 1998-99 and copied to the Council.

112 Where the return is delayed, a letter from the external auditors should be provided by 4 February 2000, explaining 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.

113 In the case of external institutions maintained by a local education authority, the Audit Commission has advised the Council that management letters are prepared for the local education authority (LEA) rather than the Council, and that all matters having a bearing on the final claim for student numbers or ISR returns should be referred to in the audit report. External auditors should make clear which matters referred to in their report have a material impact on the institution's funding, final funding unit claim or the statistical accuracy of the ISR16 return, and which matters do not. Where no material issues are identified in the report, subparagraphs 1(c) or 1(d) of the audit report should be selected.

Fraud and irregularity

114 Exceptionally, institutions and their external auditors may come across circumstances which may indicate that irregularities have occurred. The *Audit Code of Practice* describes the action that should be taken in these circumstances. It reminds colleges that the external auditor should report without delay serious weaknesses, significant frauds, and major accounting and other control breakdowns of which they are aware, to the principal, the chair of the governing body, the chair of the audit committee and to the Council's chief executive, copied to the Council's chief auditor. Failure to report serious weaknesses promptly will affect the Council's view of the credibility of returns made by the institution and subject to audit, and the credibility of the external auditor.

115 A serious weakness is one which may result in significant fraud or irregularity. 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.

There may be circumstances that do not fit this definition. In these cases or any others, colleges can seek advice or clarification from the Council's chief auditor.

116 External institutions maintained by local education authorities and HE institutions will have their own fraud and irregularity procedures which should be followed. Independent external institutions should ensure that similar procedures are in place. The Council's chief auditor should be notified as described in paragraph 114 above, where Council funding is concerned.

Return of audit reports

117 All information should be returned to regional directors at the appropriate regional office, to reach the Council by 4 February 2000. Addresses and telephone numbers for regional offices appear at annex K of supplement B to Circular 99/43. In addition, external auditors of external institutions should provide a copy of their audit report, marked 'for information only', to the sponsoring college.

