

**THE  
FURTHER  
EDUCATION  
FUNDING  
COUNCIL**

**Guidance Note  
on the College  
External  
Auditor**

**Supplement C  
to Audit Code  
of Practice**

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# GUIDANCE NOTE ON THE COLLEGE EXTERNAL AUDITOR

## Introduction

1 This guidance note supplements the audit code of practice. It gives guidance and good practice on external audit and reporting through management letters under the headings:

- terms of engagement
- audit reports and management letters
- audit of statistical returns and performance indicators
- Council access to the college external auditor
- self-assessment.

## Terms of Engagement

2 The duties of the college external auditor should be clearly presented in agreed terms of reference. A model letter of engagement for external audit is at appendix 1 to this supplement. The letter of engagement prepared by the college external auditor should incorporate these model terms.

## Audit Reports and Management Letters

3 The college external auditor's examination of financial statements normally culminates in two types of report; a formal opinion on the financial statements under review, and a management letter which reports any significant matters arising from the audit:

- which might lead to material errors or impact on future audits
- where, for example, economies could be made or resources used more efficiently.

4 A model that should be adopted for the reports of colleges' external auditors is given in the supplement issued with the most recent edition of the Council's circular, *Sector Accounting Policies*. Where there is any conflict with any provision of the Companies Acts, the Companies Acts take precedence. The Council's requirement for reports on certain statistical returns are announced by annual circular.

5 The management letter should be addressed to the governing body through the audit committee. It should be made available to the governing body with management responses before approval of the

financial statements. The finalised letter incorporating management responses should be available to the college within 30 days of the issue of the audit opinion. This also applies to any separate letters issued relating to the audit of funding unit claims.

6 The college external auditor should prepare a management letter which should recommend improvements, particularly in the following areas:

- weaknesses in the structure of accounting systems and the whole system of internal control
- deficiencies in the operation of accounting systems and the system of internal control including internal audit
- inappropriate accounting policies and practices
- non-compliance with legislation, accounting standards, other regulations and Council requirements
- matters raised in previous management letters where remedial action remains incomplete.

7 The management letter should include management's responses to any recommendations made. Where it has been agreed to implement recommendations, the person responsible and the date of completion should also be noted.

8 The college external auditor should report serious weaknesses, significant frauds, major accounting and other control breakdowns of which they are aware, without delay to the principal, the chairman of the governing body, the chairman of the audit committee and the Council's chief executive, copied to the chief auditor. Failure to report serious weaknesses promptly will affect the Council's view of the credibility of returns made by the college that are subject to audit, and the credibility of the college external auditor.

9 The external auditor must promptly send a copy of its finalised management letters, including those arising from any interim audit, audit of final funding unit claim and other reports of audit findings to the Council's chief auditor, at the same time as the original goes to the college.

10 It is likely that HM Treasury will require colleges to make a statement in their accounts for the financial year 1998-99 on their systems of internal financial control. College external auditors

are likely to be required to express an opinion on this statement. Colleges and their external auditors should ensure that the letter of engagement incorporates this likely requirement. Further guidance on this matter will be issued by the Council.

#### **Audit of Statistical Returns and Performance Indicators**

11 Paragraph 18 of Circular 92/07 indicated that the Council would require colleges to have the accuracy of certain statistical returns to the Council certified by college external auditors. To date, college external auditors have been required to provide reports to the Council on the audit of final funding unit claims, and on the individualised student record (ISR) data. Other requirements have included provision of a specified report where colleges have work-based collaborative provision in loadbands 5 and 6.

12 The nature of this work is that it is related to, but separate from, the college external auditor's recurring work on the college's financial statements. The Council has already indicated that it will require access to auditors' working papers relating to this work. The NAO, as external auditor to the Council, may also require access to working papers. *The matter of access to working papers has not yet been finalised.*

#### **Council Access to the College External Auditor**

13 On occasion, the Council's audit service may wish to meet with the college external auditor. The Council has also begun to review the work performed by external auditors in auditing final funding unit claims and a programme of reviews, based on a sample of colleges each year, is being introduced.

14 Among the tasks necessary in conducting such a review, the Council's audit service will examine the college external auditor's working papers relating to this work, and will interview key personnel from the college's external auditor. For those external auditors sampled in a year, the Council anticipates requiring not more than one day's contact time with them. More time will be required where the Council finds that the college external auditor's work has not been conducted satisfactorily. This liaison should not normally give rise to additional fees. The Institute of Chartered Accountants in England & Wales have indicated that

access to audit working papers should be covered by hold harmless letters.

#### **Self-assessment**

15 Appendix 2 to this supplement is a checklist which is offered to colleges to assist them to assess their external audit arrangements. It is not part of the audit framework.

# MODEL LETTER OF ENGAGEMENT FOR THE COLLEGE EXTERNAL AUDITOR

To the governing body of [ ] College

## Engagement Letter External Audit

1 Following our appointment as external auditor of [ ] College [and its subsidiaries] by the governing body, we set out below what we consider to be the basis on which we are to act as external auditor to the college and the respective areas of responsibility of the college and of us. This engagement letter incorporates the full requirements of the model letter of engagement for college external auditors set by the Further Education Funding Council (the Council).

## Appointment and Qualification

2 We acknowledge that the governing body shall consider annually the reappointment of the college external auditor. Remuneration shall be fixed by the governing body on the advice of the audit committee. A new competition for the selection of auditors shall be held at least every five years.

3 We confirm that we are qualified to be appointed as external auditor for the college in accordance with the requirements of paragraph 52 of the Council's audit code of practice. We shall have the right of access at all times to the books, accounts and vouchers of the college, minutes of governing body and management meetings, and such information and explanations as are necessary for the performance of our duties in accordance with the requirements of the Council.

## Responsibilities of the College and Auditor

4 The governing body is responsible for ensuring that:

- a. a system of controls, financial and otherwise, is established and maintained in order to carry on the operations of the college in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure, as far as possible, the completeness and accuracy of the records;
- b. proper accounting records are maintained;
- c. financial statements are prepared that:
  - i. comply with the college's articles of government, all statutory requirements,

the financial memorandum between the Council and the college, the Council's accounts directions and any other regulations relevant to the constitution and activities of the college

- ii. show a true and fair view of the college's financial position and of the income and expenditure for the year taking into account where relevant: statutory disclosure requirements; statements of standard accounting practice; financial reporting standards and other Accounting Standards Board (or its predecessor the Accounting Standards Committee) requirements and the requirements of the Council;
  - d. statistical returns are prepared in accordance with Council requirements.
- 5 We shall make a report to the governing body on the financial and statistical statements examined by us, copies of which are to be laid before the governing body during our tenure of office.
- 6 Our report shall state whether in our opinion the financial statements show a true and fair view and whether they have been properly prepared in accordance with paragraph 4c(ii) above.
- 7 We shall also report to the governing body whether:
- a. in all material aspects monies expended out of funds from whatever source administered by the college for specific purposes have been properly applied to those purposes and, if relevant, managed in compliance with relevant legislation such as the *Trustees Investment Act 1961*;
  - b. in all material respects monies expended out of funds provided by the Council have been applied in accordance with the financial memorandum between the Council and the college and any other terms and conditions attached to them.
- 8 In arriving at our opinion we are also required to consider the following matters, and to report on any aspect of which we are not satisfied:
- a. whether proper accounting records have been kept by the college;
  - b. whether the college's balance sheet and income and expenditure account are in agreement with the accounting records;

- c. whether we have obtained all the information and explanations which we consider necessary for the purposes of our audit;
- d. whether the information given in the report of the governing body is consistent with the financial statements.

9 We have a professional responsibility to report if the financial statements do not comply in any material respect with applicable accounting standards, unless in our opinion the non-compliance is justified in the circumstances. In determining whether or not the departure is justified we consider:

- a. whether the departure is required in order for the financial statements to give a true and fair view and;
- b. whether adequate disclosure has been made concerning the departure.

10 [If the college is a limited company this paragraph should be inserted.] In preparing our report it is our duty to carry out such investigations as will enable us to form an opinion as to whether:

- a. the college's financial statements are in agreement with the accounting records;
- b. the financial statements have been properly prepared in accordance with the *Companies Act*.

11 A model audit report is given in the supplement issued with the most recent edition of the Council's circular, *Sector Accounting Policies*. We shall not depart from the model without consulting the Council's chief auditor.

12 The Council will also require the college to have the accuracy of certain of its statistical returns to the Council certified by us in a form determined by the Council.

13 We shall report by way of management letter, when we issue our opinion on the annual financial statements to the governing body through the audit committee. A copy of the management letter, including those issues arising from any interim audit, audit of final funding unit claim and other reports of audit findings shall be sent by us direct to the Council's chief auditor at the same time as the original is sent to the college. Only final versions including the college's reply, of such documents, shall be sent to the Council, not drafts. The management letters shall include any significant

matters arising out of the audit which might lead to material errors or impact on future audits, or where, for example, economies could be made or resources used more efficiently. It shall also recommend improvements, particularly in the following areas:

- a. weaknesses in the structure of accounting systems and the whole system of internal control;
- b. deficiencies in the operation of accounting systems and the whole system of internal control including, where appropriate, internal audit;
- c. inappropriate accounting policies and practices;
- d. non-compliance with legislation, accounting standards, other regulations and Council requirements;
- e. matters raised in previous management letters where remedial action remains incomplete.

14 Where a serious weakness or an accounting or other control breakdown is identified, it must be reported to the principal, the chairman of the governing body and the chairman of the audit committee without delay. Such weaknesses or breakdowns must be reported to the chief executive of the Council, copied to the chief auditor.

#### **Scope of Audit**

15 We shall conduct our audit of the college's financial and statistical statements and such other matters as the governing body requires in accordance with auditing standards issued by the Auditing Practices Board and in full accordance with any instructions issued by the Council.

16 The nature and extent of our procedures will vary according to our assessment of the college's accounting system, and where we wish to place reliance on it, the internal control system, and may cover any aspect of the college's operations that we consider appropriate.

17 As part of our normal audit procedures, we may request you to provide written confirmation of certain oral representations which we have received from you during the course of the audit on matters having a material effect on the financial statements.

18 We shall review the working papers of internal auditors, to the extent that we propose to rely on them.

**Access**

19 We expect to have unrestricted access to the files and working papers of the college internal audit service, and to have regular meetings with internal audit personnel. We, in turn, agree to comply with any requests from the Council's audit service and the NAO for access to any information, files or working papers obtained or prepared during the course of our audit that they need to discharge their responsibilities. *The matter of access to working papers has not yet been finalised.*

**Irregularities, Including Fraud and Corruption**

20 Ensuring the establishment and maintenance of an adequate system of internal control is the responsibility of the governing body with which rests also the responsibility for ensuring compliance with statutory and other regulations, including those in relation to taxation, and for the prevention and detection of irregularities, including fraud and corruption. We shall plan and conduct our audit so that we have a reasonable expectation of detecting material mis-statements in the accounts resulting from irregularities, including fraud or corruption, or breach of regulations. We are not required under this letter of engagement to search specifically for irregularities and fraud or corruption and our audit should not therefore be relied on to disclose them. We shall report to the Council's chief executive, copied to the chief auditor, without delay, any serious weaknesses, significant frauds, major accounting and other control breakdowns of which we are aware.

**Other Work**

21 We may also be asked from time to time to provide additional services, including value-for-money or other investigations beyond the scope of the audit described in this letter of engagement. Precise requirements shall be agreed between ourselves and the governing body. In these circumstances both ourselves and the governing body should be satisfied that no conflict of interest could, or be perceived to, arise.

**General Meeting**

22 We shall be entitled to attend any general meetings of the governing body and to receive all notices or any other communications relating to any general meeting which any member of the governing body is entitled to receive, and to be heard at any

general meeting which we attend, or any part of the business of the meeting which concerns us as the college external auditor.

**Termination of Appointment**

23 The governing body may by resolution remove us as the college external auditor before the expiration of our term of office, notwithstanding any agreement between us and the college. We, as the college external auditor, may resign before the end of our term of office.

**Fees**

24 [A paragraph setting out the college external auditor's basis for charging and collecting fees should be included.]

**Agreement of Terms**

25 If the contents of this letter are not in accordance with your understanding of the arrangements made, we shall be pleased to receive your observations and to give you any further information you require. Otherwise, we shall be grateful if you would confirm in writing your agreement to the terms of this letter by signing the enclosed copy and returning it to us.

Yours sincerely,

[ ]

On behalf of the governing body, I confirm the above terms in respect of [ ] College.

Signed .....

Name .....

Position .....

Date .....

*Note: Firms may include reference to the Financial Services Act 1986 which provides general protection to corporate finance clients for whom firms carry out investment business.*

## **SELF-ASSESSMENT CHECKLIST FOR EXTERNAL AUDIT ARRANGEMENTS**

### **Qualification of External Auditor and Scope of Work**

- the college external auditor is suitably qualified and has been selected in accordance with the audit code of practice
- the scope of external audit covers the truth and fairness of the financial position of the college and any subsidiary companies shown in the financial statements
- the scope of external audit covers other requirements of the Council.

### **College External Auditor's Management Letters**

- management letters have been issued to, and responded to promptly by the college. They should be made available with management responses, in final form, to the college before approval of the financial statements. The finalised letter incorporating management responses should be available to the college within 30 days of the issue of the audit opinion
- management letters include any significant matters arising out of the audit which might lead to material errors or impact on future audits
- management letters cover other matters such as where economies could be made or resources used more efficiently
- management letters make recommendations on weaknesses in the structure of accounting systems and the whole system of internal control
- management letters highlight deficiencies in the operation of accounting systems and other internal controls, including the internal audit service
- management letters highlight inappropriate accounting policies and practices
- management letters highlight non-compliance with legislation, accounting standards and other regulations, and the Council's requirements

- management letters highlight matters raised in previous management letters where remedial action remains incomplete
- management letters highlight any significant weaknesses in the whole system of internal control and are consistent with reports of the internal audit service
- senior management has accepted issues raised in management letters and taken, or planned to take, prompt action to rectify the situation
- the audit committee has received management letters and monitored implementation of agreed recommendations
- a copy of the finalised management letter has been sent to the Council at the same time as it was sent to the college.

### **Audit of Statistical Returns**

- the scope of the college's external audit covers the Council's requirements
- the college external auditor has notified the college and the Council of any serious weaknesses or breakdown in the student records, data recording or other relevant systems
- senior management has accepted issues raised in management letters and taken, or planned to take, prompt action to rectify the situation
- the audit committee has received management letters and monitored implementation of agreed recommendations
- the audit committee has received any reports from the Council's audit service and monitored the implementation of agreed recommendations.

### **Additional Work by the College External Auditor**

- for additional work given to the external auditor by the college, the governing body has approved in advance its extent and nature unless the additional work each year is less than 50 per cent of the external audit annual fee (including the fee for audit of funding unit claims)



- for additional work, the governors and the college external auditor have ensured that it did not impair the objectivity of the auditor when forming its audit opinion
- the college external auditor has notified the college and the Council of any serious weaknesses, significant frauds or major accounting and other control breakdowns, without delay.

