

Circular 04/07

For Information

Audit

Audit Code of Practice

Summary

This circular introduces the Audit Code of Practice (the code) for the post-16 education and training sector. The code is effective until further notice and supersedes the Interim Audit Code of Practice set out in Learning and Skills Council (LSC) Circular 03/04. This circular also reports on the outcomes of the consultation on changes to the audit requirements for further education (FE) colleges set out in a letter dated 28 June 2004.

This circular is of interest to management, governors and auditors of FE colleges and providers within the post-16 education and training sector that are funded by the LSC, to Executive Directors and Finance Directors at local Learning and Skills Councils (local LSCs), and to LSC provider financial assurance staff.

In this circular, the date style 2003-04 indicates a financial year, and 2003/04 indicates the academic year.

Supersedes

This circular supersedes Circular 03/04.

December 2004

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Further information

For further information, please contact:

Provider Financial Assurance Service Centre

Learning and Skills Council

Cheylesmore House

Quinton Road

Coventry

CV1 2WT

Tel: 024 7649 3993

Website:

<http://www.lsc.gov.uk/National/Documents/SubjectListing/FundingLearning/ProviderFinance/ProviderFinancialAssurance>

Director, Assurance Policy

Louise Mellor

Learning and Skills Council

St Lawrence House

29–31 Broad Street

Bristol

BS99 7HR

Tel: 0117 372 6518

Email: louise.mellor@lsc.gov.uk

Regional Audit Manager (London)

Steve Passmore

Learning and Skills Council

Centre Point

103 New Oxford Street

London

WC1A 1DR

Tel: 020 7904 0788

Email: steve.passmore@lsc.gov.uk

Contact details for Regional Audit Managers can be found on the LSC website (www.lsc.gov.uk/National/Documents/SubjectListing/FundingLearning/ProviderFinance/ProviderFinancialAssurance/Contactdetails.htm).

Executive Summary

Date: November 2004

Subject: The purpose of this circular is to introduce the revised Audit Code of Practice (the code) that applies to the post-16 education and training sector until further notice. The code includes the mandatory audit arrangements for further education (FE) colleges as well as summarizing the audit arrangements for the LSC's principal funding of other providers.

This circular also reports on the outcome of consultation set out in a letter to FE colleges dated 28 June 2004. That letter consulted on changes to the mandatory audit requirements for FE colleges resulting from the introduction of plan-led funding and regularity audit. Some minor changes to the code have also arisen as a result of the internal reorganization of the Learning and Skills Council (LSC). The code reflects the majority of the comments received and is effective from 1 August 2004.

Intended recipients: This circular and the code will be of interest to all providers of education and training in the post-16 sector, including those working in FE colleges and sixth form colleges, and those providing work-based learning and adult and community learning (ACL) provision. The code is recommended for senior management, members of management teams and governors and auditors of learning providers that receive LSC funding. Other recipients include Executive Directors and Finance Directors at local Learning and Skills Councils (local LSCs), LSC provider financial assurance staff and other bodies with an interest in audit such as the Higher Education Funding Council for England (HEFCE).

Status: For information and action.

Audit Code of Practice

Introduction

- 1 This circular introduces the revised Audit Code of Practice (the code) and reports the outcomes of the consultation with further education (FE) colleges set out in a letter to all college principals dated 28 June 2004.
- 2 Two working groups have been liaising with the Learning and Skills Council (LSC) on the code and considering the proposals for further developments. The Audit Code of Practice Working Group included representatives from the Association of Colleges (AoC) and the Association of College Registrars and Administrators (ACRA), the Department for Education and Skills (DfES), the National Audit Office (NAO) and auditing firms. The Internal Audit Working Group included representatives of FE college internal audit services.
- 3 The Audit Code of Practice Working Group and the Internal Audit Working Group each met on two occasions. Both groups considered the consultation proposals and responses, and the views expressed have influenced the code. Membership of the two groups is given in Annex A. The LSC thanks both working groups for their contribution. The LSC has also worked with the AoC in presenting these changes to FE colleges at recent seminars and has gained further views from colleges at these and other events.

Structure

- 4 The main body of this circular provides an introduction and background to the code and the consultation that preceded it.
- 5 Supplement A contains the code. Supplement B includes model documents for adoption under the code by FE college audit committees, their internal audit service and financial statements auditors (also known as “external” auditors).

Guidance on changes

- 6 As with the Interim Audit Code of Practice (the interim code), this code focuses on mandatory audit requirements for FE colleges and those model documents needed to meet these mandatory requirements. Supplementary guidance notes to the interim code, which are also applicable to this version of the code, were published jointly with the AoC and ACRA in October 2003. The major changes in this version of the code relate to the introduction of plan-led funding from 2004/05 and the resultant effects on the assurance regime.
- 7 The other changes to the code have resulted from the internal reorganization of the LSC. The Provider Financial Assurance (PFA) Service Centre is now organized into nine regions. Where audit reports were previously submitted to the heads of PFA of local LSCs, these

should now be sent to Regional Audit Managers. This is detailed in the body of the code.

- 8 FE colleges and providers with queries on how to apply the code may also wish to consult their auditors or the LSC. The LSC can be contacted by email at audit.code@lsc.gov.uk or by telephone to the Regional Audit Manager of the PFA Service Centre. Contact details for Regional Audit Managers are detailed on the LSC's website (www.lsc.gov.uk/National/Documents/SubjectListing/FundingLearning/ProviderFinance/ProviderFinancialAssurance/Contactdetails.htm).

Future developments

- 9 The LSC intends to keep the operation of the code under review and will consult interested parties before making any significant amendments.
- 10 Audit arrangements are a direct product of the LSC's terms and conditions of funding and the LSC is working to harmonize these arrangements as far as possible. The LSC intends to integrate its harmonized audit arrangements into later versions of the code, so that the code will eventually be a condition of funding for all providers.
- 11 During 2004-05, the LSC plans to pilot plan-led funding in respect of work-based learning (WBL) provision that takes place at colleges. This would end the need for a year-end reconciliation and recovery process and would therefore have significant implications for both funding and assurance arrangements. In such cases, this funding could be covered totally by the regularity audit and no detailed WBL funding audit would be necessary. The LSC is further seeking to pilot the end of reconciliation and recovery, and associated funding audit, with commercial and charitable providers. This change would require these providers to be funded under grant and hence be subject to regularity audit.

Background

Accountability

- 12 In issuing the interim code in Circular 03/04, the LSC highlighted that the accountability arrangements expressed in the interim code were changing and would continue to change as the LSC harmonized its terms and conditions of funding. Circular 03/04 also noted the LSC's work to that date in reducing bureaucracy. Since the interim code has been issued, the LSC has made major changes to its FE funding methodology and progress in reducing bureaucracy. These changes permit and require major changes to the LSC's audit requirements of FE colleges. These changes are underpinned by a move from detection and control by the LSC over colleges' financial delivery, to a trust-based relationship of college governors and managers taking responsibility for the open and transparent spending of LSC funds.

Reducing bureaucracy

- 13 In autumn 2001, the LSC established the Bureaucracy Task Force (BTF) chaired by Sir George Sweeney, a Council member and the principal of Knowsley Community College. The BTF's remit, in its first year of work, was to review the burden of bureaucracy on FE colleges. It reported its findings in November 2002.
- 14 One area the BTF considered at length was the audit of FE colleges. Its members raised significant concerns about the extent and frequency of audit of colleges, particularly funding audit. Many colleges commented that they were spending significant additional resources that they would not otherwise spend, on servicing the funding audit. The BTF accepted that the extent of FE college funding audit was largely a direct product of the nature of the funding methodology. The LSC was able to make some progress in reducing funding audit even under the funding methodology inherited from the Further Education Funding Council (FEFC). Thus in 2002/03, as a response to the findings of the BTF, 20 pilot colleges were taken out of full funding audit. A further 97 pathfinder colleges were taken out of full funding audit in 2003/04.
- 15 Further reductions in funding audit depended on the introduction of plan-led funding for the majority of colleges and this has happened in 2004/05. Plan-led funding has meant an end to the automatic year-end reconciliation and clawback process and hence an end to funding audit for most colleges. The cessation of funding audit and the introduction of regularity audit in 2004/05 has resulted in the lightest touch audit regime that FE colleges have seen since the incorporation of colleges in 1993 (see Table 1). The new audit regime will save significant funds previously spent by the LSC on funding audit work at colleges. The new audit regime will also save the additional resources colleges reported to the BTF, and elsewhere, as being required to service a detailed funding audit. These savings, in terms of time, cost and management distraction, will now be available for learning provision.

Table 1: Significant audit arrangements for FE colleges, 1993 to 2004.

Audit type	Period		
	1993 to 2000	2000 to 2004	2004/05
Internal	Yes, appointed by college	Yes, appointed by college	Yes, appointed by college
Financial statements	Yes, appointed by college	Yes, appointed by college	Yes, appointed by college
Regularity	Yes, appointed by college	Yes, appointed by college	Yes, appointed by college
Funding (Individualized Learner Record)	Yes, appointed by college	Yes, appointed by LSC	Only at colleges not yet in plan-led funding

- 16 The LSC recognizes that while plan-led funding has changed risks to both the LSC and to colleges as set out below, some risks under the FEFC's funding methodology remain. If these risks, old or new, materialize, control through increased audit may be reintroduced. The LSC sees the BTF's principal recommendation, in its May 2004 report (*Extending Trust: A report of the Bureaucracy Task Force*) that colleges

regulate themselves, as the key to preventing such a re-imposition of control. Self-regulation is by definition something that the LSC cannot and should not try to do to colleges; it is for colleges themselves to do this. The LSC can, and will, support self-regulation and will make further reductions in audit in line with its introduction, where these reductions can be justified.

- 17 The assurance regime for colleges set out in the code is close to that present in other parts of the English education sector. The key elements of the regimes for local education authority (LEA)-maintained education providers, higher education (HE) institutions and FE colleges are set out in Table 2.

Table 2: Key elements of audit regimes at providers.

Type of audit	LEA maintained education providers	Higher education institutions	Further education colleges
Financial statements	Through work of Audit Commission	Yes, appointed by HE institution	Yes, appointed by college
Regularity	Through work of Audit Commission	Yes, appointed by HE institution	Yes, appointed by college
Internal	Through the local authority	Yes, appointed by HE institution	Yes, appointed by college
Funding	May be part of internal audit. LSC commissions for schools with sixth forms	Yes, on risk-based cycle performed by HEFCE ("data audit")	For colleges not yet in plan-led funding. Risk-based cycle performed by LSC for remainder

Changes to risk under plan-led funding

- 18 Between 1994/95 and 2003/04, colleges were funded under a methodology in which money very closely followed the learner. The FEFC, and then the LSC, gave colleges a funding allocation that was the best joint estimate of what activity the college would deliver. Colleges would then deliver learning, and collect data on what they delivered. The LSC paid colleges a monthly profile on account against the total allocation for the year. Colleges converted that part of the data that had funding implications into a money value, using the LSC's national rates for each element of learning. The total money value of delivery was then reconciled to the total allocation paid on account.
- 19 Colleges submitted a funding claim to the LSC and this funding claim was audited in depth every year. Where a college under-performed against its allocation, the LSC sought to recover unearned funds through clawback. Where a college over-performed against its allocation, the LSC may have funded this over-delivery.
- 20 This funding relationship meant that the LSC's expenditure figure in its own financial statements varied according to how much colleges delivered. Also, the LSC had a debtor figure in its accounts for the clawback due from colleges, and a creditor figure for over-performance that the LSC intended to fund. The expenditure and debtor figures were material figures in the LSC's financial disclosures, both by nature and by value.

- 21 The LSC must demonstrate to its external stakeholders, and in particular the NAO, that it has sufficient assurance that the figures in the financial statements are true and fair. The LSC therefore required all colleges' funding claims to be audited in depth every year, to prove the accuracy of key figures in the LSC's own financial statements.
- 22 Plan-led funding breaks the automatic link between funding and performance. The LSC assumes a college's total allocation for a year to be fixed. The LSC will change the allocation, by negotiated agreement, where a college is performing at a different level from the allocation. These negotiations are informed, but not dictated, by the value of earnings calculated by actual delivery through data with funding implications. The LSC therefore no longer requires an annual funding audit of every college's funding claim, as the LSC's own financial statements are subject to less uncertainty. It is sufficient for the LSC to gain most of its financial assurance over the value of colleges' spending of LSC funds, through colleges' own assurances to the LSC and through regularity audit. In respect of colleges' internal control, the LSC again gains assurance from colleges direct and through the work of college internal audit services.

The importance of the regularity audit

- 23 Regularity audit has been in place for all FE colleges since 1993/94, and previously, when colleges were under local government control. Regularity audit is not a new requirement for colleges. Both colleges and the LSC did see regularity audit as having lower importance in informing evidence of the use of public funds, since both had the more significant evidence of the funding audit available to them. In other words, with the funding audit in place, the LSC did not consider it necessary to set out its expectations of regularity audit.
- 24 With funding audit discontinued for most colleges, the LSC does now need to be sure that regularity audit is performed to a good common standard across all colleges. Regularity audit is now the LSC's key source of assurance over the use of funds.
- 25 For those colleges where regularity audit has always been of a good standard, the extent of regularity audit is not expected to change significantly. For those colleges where regularity audits may have been done less well in the past, the extent of these audits will increase. Financial statements auditors will also seek to rely on the work on key financial systems carried out by internal auditors and other auditors. This would reduce the level of regularity audit work.
- 26 Many colleges are now compensating for the end of funding audit and the assurance it gave colleges and managers on the college's main income line, LSC funding. In particular, funding audit is now acknowledged by many colleges to have given them a high standard of assurance on their internal control over their key learner numbers systems. Understandably, colleges are now looking to their internal auditors, their financial statements auditors or other consultants, to give them this assurance.

Colleges' management of risk

- 27 The LSC considers that this properly allows colleges to manage risk by reviewing all controls and sources of assurance available to them, and adding assurance where risks are not managed. Colleges will make their own decisions to appoint additional audit or other consultancy work to this end. The extent and cost of this work will be for colleges and not the LSC to decide. Under funding audit, the LSC effectively made this decision for colleges.
- 28 Where colleges are making decisions about the need for additional assurance, it should be recognized that the risk to colleges' income lines has changed and that levels of assurance based on matching the past regime may no longer be needed. The LSC does not intend to automatically claw back for under-performance for colleges in plan-led funding in 2004/05 onwards. The uncertainty, and hence immediate risk, to colleges' main income line of the chain of accountability from individual learner events, through data, conversion into funding, precise reconciliation, audit and automatic clawback, is no longer present. Colleges should therefore consider the changed nature of risk in their LSC income line and whether, and to what extent, it is necessary to appoint auditors or consultants to address financial risks present before plan-led funding.

Addressing residual risks

- 29 Although the LSC will no longer require reconciliation and audit against its detailed funding methodology, it does not have the power to waive its legal responsibilities, and nor can it ignore commonsense tests of existence. The LSC has to continue to address risks of misapplication of funds against these two tests.
- 30 To tackle these residual risks of learner non-existence and ineligibility, the LSC will devise a programme of work that is in direct and marked proportion to risk. Under plan-led funding, those colleges that manage their provision well will only need minimal and infrequent coverage of residual risks to existence and eligibility. HEFCE practice suggests that this might be on a cycle of several years. Where the LSC identifies higher risk provision at a college, this provision will be subject to more frequent audit, possibly as frequently as annually for the highest risk provision.
- 31 Such reviews of funding data are not assumed to lead automatically to financial recovery by the LSC from colleges. The key test will be, as for regularity audit, whether there has been any actual loss to the public purse through the mis-spending of LSC funds. Again, the LSC does not normally intend to extrapolate the results of its reviews retrospectively to all the years between those reviews, unless there is exceptional evidence of deliberate irregularity and impropriety.

Regularity audit

- 32 The introduction of regularity audit has implications for all college auditors. The work will be carried by financial statements auditors, based

on a self-assessment questionnaire. Regularity audit will be carried out in two stages, interim (reporting to 31 March) and final (reporting to 31 July). The LSC is seeking a duty of care over this work through a three-way relationship, although colleges should note that the LSC does not wish to become involved in any other part of the audit assignment, for example, discussions over numbers of audit days or audit fees. The LSC is working with audit firms and the Institute of Chartered Accountants in England and Wales to produce a model letter of engagement for auditors to use. This will be published as soon as it is finalized. There will be a letter of engagement between the college and the financial statements auditor that will refer to the duty of care owed to the LSC by the auditor in respect of regularity audit. There will be a second letter between the financial statements auditor and the LSC, giving a formal duty of care over the regularity audit work at all of their client colleges.

- 33 The LSC is in the process of finalizing the regularity audit framework within which financial statements auditors will be expected to operate. Five regularity audit pilots have taken place and these were completed in November 2004. The LSC will publish the regularity audit framework.
- 34 Historically, there have been very few instances of college financial statements auditors reporting irregularity or impropriety in the use of public funds. The LSC does not expect a significant increase in the reporting of irregularity as a result of these changes, although the need to report continues to be a matter of judgement by regularity auditors.

Charitable status of colleges

- 35 The draft Charities Bill (the Bill), published in May 2004, potentially places further requirements on the LSC as primary regulator of exempt charities in the FE sector. In particular, the draft Bill highlights the requirement for colleges, and the LSC as regulator, to be concerned with the application of their assets regardless of their source. This reflects the ethos that there should be no distinction in the sources of income when considering how a college spends its funds. This is unlikely, therefore, to have a significant impact on the scope of regularity audit work as the proposals cover all expenditure, regardless of the source. If the draft Bill progresses to statute, the LSC will be formally concerned that the regulatory framework embraces college funds from all sources and that colleges comply with all aspects of charity law.

Responses to Consultation

- 36 The LSC received 151 responses to the consultation letter dated 28 June 2004. The LSC thanks respondents for contributing to the consultation process. Responses were received from:
- the AoC
 - ACRA London Region
 - the DfES

- the Higher Education Funding Council for Wales (HEFCW) and Education and Learning Wales (ELWa) (joint response)
 - 130 FE colleges, including governing bodies, audit committees, clerks to the governing bodies, principals and finance directors
 - one HE institution
 - 15 accountancy firms and internal audit providers
 - the Chartered Institute of Public Finance and Accountability (CIPFA).
- 37 A summary of the responses to the consultation and the response from the LSC is attached at Annex B.
- 38 The code incorporates changes arising from responses to the consultation, most of which relate to the changes resulting from the introduction of plan-led funding.

Chief Executive, LSC

Annex A: Membership of Working Groups

Audit Code of Practice Working Group

David Coates*	Clerk to the Corporation, The People's College Nottingham, West Nottinghamshire College and East Riding College; member of the Association of Colleges and Association of College Registrars and Administrators Steering Committee
Patrick Green	Partner, Bentley Jennison
Karen Hagan*	Finance Director, Somerset College of Arts and Technology; Vice-chair, Colleges Finance Directors Group
Russell Harrod	Audit Manager, National Audit Office
Ian Mason	Audit Policy Manager, Learning and Skills Council
Louise Mellor	Director, Assurance Policy, Learning and Skills Council
Peter Newson	Director, External Assurance, Learning and Skills Council
Steve Passmore	Regional Audit Manager, Learning and Skills Council
Mike Rowley	Director, KPMG LLP
Adrian Rutter	Director, Risk and Assurance Services Tenon Ltd; Director, Public Sector Services Blueprint Audit Ltd
Keith Slaughter	Audit Manager, National Audit Office
Pauline Tiller	Director of Finance and Policy, Learning and Skills Council Kent and Medway
Martin Wilson	Governance and Organization Team, Department for Education and Skills
Vickie Wood	Governance and Organization Team, Department for Education and Skills

**nominated by the Association of Colleges*

Internal Audit Working Group

Stephen Clark	Senior Manager, KPMG LLP
Simon Craven	Senior IA Manager, Scrutton Bland
Louise Mellor	Director, Assurance Policy, Learning and Skills Council
Ian Falconer	Partner, RSM Robson Rhodes
Patrick Green	Partner, Bentley Jennison
Sue Harris	Partner, Baker Tilly
Martin Hill	Director of Audit Services, East Riding Audit Consortium
Matthew Hodge	Senior Manager, PricewaterhouseCoopers
David Morris	Manager, MacIntyre Hudson
Robin Pritchard	Partner, Pritchard Wood
Adrian Rutter	Director, Risk and Assurance Services Tenon Ltd Director, Public Sector Services Blueprint Audit Ltd
Karen Shaw	Manager, Hampshire Audit Services
Ian Stafford	Principal Auditor, Learning and Skills Council
Rob Turton	Partner, BDO Stoy Hayward

Annex B: Responses to Consultation

Consultation area	Supportive %	Not supportive %	Other/no view %	Comments
Learner existence and eligibility				
1 The LSC intends to cover the risks of learner non-existence and ineligibility through a risk-based programme of work. Please comment on the implementation of this approach.	89	2	9	<p><i>Supportive responses recognized that residual risks flagged up by funding audit need to be covered. Some respondents wished to see further details of the proposed programme of work, and were concerned at the possible duplication of internal audit work.</i></p> <p>The LSC is still developing its approach to learner existence and eligibility work and will keep colleges informed. It will be designed to minimize any duplication of work.</p>
Regularity audit				
2 Do you agree that regularity audit should be based on a college self-assessment process that can then be used to contribute to other audit work, minimizing the duplication of audit work and associated costs?	92	3	5	<p><i>This was strongly supported. Respondents commented that the self-assessment process should not create extra burdens on colleges and guidance should be provided to ensure that self-assessment is consistent across colleges.</i></p> <p>The LSC will bear these points in mind as it develops the regularity audit framework. In particular, it will aim to eliminate duplication between the regularity audit and the financial management and governance reviews undertaken by the Provider Financial Assurance Service Centre alongside inspections.</p>

<p>3 Do you agree that colleges should, as part of their corporate governance responsibility statements, give the LSC assurances on the colleges' proper and regular use of funds based on all evidence available to the college (including the regularity audit self-assessment)?</p>	<p>90</p>	<p>7</p>	<p>3</p>	<p><i>This was strongly supported.</i></p>
<p>4 Do you agree that college financial statements auditors should deliver annual independent assurance on colleges' regular and proper use of LSC and other funds? If not, which is your preferred option?</p>	<p>90</p>	<p>7</p>	<p>3</p>	<p>This approach was strongly supported, with some comments that the duty of care issue needs to be resolved so that the financial statements auditors are able to provide assurance to the LSC. This has been adopted in the code.</p>

<p>5 Do you agree that the LSC should secure its duty of care for regularity audit opinions by becoming a party to the letter of engagement between colleges and their financial statements auditors?</p>	68	24	8	<p><i>This proposal was largely supported. Some respondents queried the necessity for it; others asked whether audit firms would be willing to enter such a tripartite arrangement. Others expressed concern that the auditors' accountability would be blurred and a precedent would be set for the LSC to instruct colleges' advisers. Most of the "not supportive" responses were concerned that the LSC would be taking away some of colleges' independence.</i></p> <p>The LSC is working with audit firms and the Institute of Chartered Accountants in England and Wales to develop some mutually acceptable wording for the letter of engagement. The LSC is not seeking to reduce colleges' independence: it does not seek to become involved in discussions over audit days and fees.</p>
Internal audit				
<p>6 Do you think that the LSC should prescribe the level of coverage of colleges' learner numbers systems by college internal auditors?</p>	22	71	7	<p><i>This proposal was in general not supported. Respondents commented that colleges are not all the same and the level of coverage is best left to internal auditors who are able to plan according to colleges' individual circumstances.</i></p> <p>This proposal has not been adopted in the code. The level of coverage of internal audit work should be a matter for discussion between the college and the internal auditors.</p>

<p>7 Do you think the LSC should require annual coverage of learner numbers by internal auditors?</p>	<p>42</p>	<p>54</p>	<p>4</p>	<p><i>Respondents made similar comments in their responses to this question as they did to question 6. Many comments noted that it would in any case be unusual for annual coverage of learner numbers not to be the norm.</i></p> <p>This proposal has not been adopted in the code. The internal audit of learner numbers systems should be risk-based rather than an automatic annual process and should be a matter for discussion between the college and the internal auditors.</p>
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Supplement A to Circular 04/07

Audit Code of Practice

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Further information

For further information, please contact:

Provider Financial Assurance Service Centre

Learning and Skills Council

Cheylesmore House

Quinton Road

Coventry

CV1 2WT

Tel: 024 7649 3993

Website:

<http://www.lsc.gov.uk/National/Documents/SubjectListing/FundingLearning/ProviderFinance/ProviderFinancialAssurance>

Director, Assurance Policy

Louise Mellor

Learning and Skills Council

St Lawrence House

29–31 Broad Street

Bristol

BS99 7HR

Tel: 0117 372 6518

Email: louise.mellor@lsc.gov.uk

Regional Audit Manager (London)

Steve Passmore

Learning and Skills Council

Centre Point

103 New Oxford Street

London

WC1A 1DR

Tel: 020 7904 0788

Email: steve.passmore@lsc.gov.uk

Contact details for Regional Audit Managers can be found on the LSC website (www.lsc.gov.uk/National/Documents/SubjectListing/FundingLearning/ProviderFinance/ProviderFinancialAssurance/Contactdetails.htm).

Audit Code of Practice

Section 1: Introduction

Introduction

- 39 This Audit Code of Practice (the code) sets out:
- the broad accountability framework in which the Learning and Skills Council and the providers it funds operate (Section 2)
 - the mandatory audit requirements on further education colleges that the Learning and Skills Council funds (Section 3)
 - the audit requirements on Ufi Ltd, operating through learndirect hubs (paragraph 119, Section 5)
 - for information, a summary of the audit arrangements for local authority providers (Section 4) and other funding streams and provider types that the Learning and Skills Council funds (Section 5)
 - information on other relevant review and audit activities within and outside the Learning and Skills Council that other providers may be subject to.
- 40 The code will be of interest to management, governors and auditors of organizations within the post-16 education and training sector that are funded by the Learning and Skills Council (LSC). Within this sector, the LSC primarily funds by value further education (FE), school sixth form, work-based learning (WBL) and adult and community learning (ACL) provision. The LSC funds organizations drawn effectively from across the whole of the economy, including FE colleges, higher education (HE) institutions, central government bodies, local authorities and voluntary and commercial organizations of very varied sizes and legal forms.

Further education colleges

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

Other providers

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

conditions relating to its audit requirements.

Observance

- 43 In Section 3 of the code relating to FE colleges, the terms “must” and “will” indicate mandatory requirements included in the code. For ease of reference, mandatory requirements for FE colleges are summarized at Annex A of Supplement B to this Code. Supplement B also includes model documents relevant to FE colleges. FE colleges must adopt these documents, or require their auditors to adopt these documents, in order to comply with the requirements of the code.
- 44 Sections 4 and 5 of the code are for information and do not set out mandatory requirements for other providers. The LSC’s audit requirements of other providers are given in their individual funding agreements with the LSC. Other providers must refer to these funding agreements for the LSC’s mandatory audit requirements.
- 45 The LSC will look for compliance with the mandatory requirements of the code or of funding agreements when considering providers’ financial management, governance, internal control and application of LSC funds.

Applicability

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

Scope of the code

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

Section 2: General Accountability in the Sector

Introduction

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

Government accountability

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

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

Department for Education and Skills

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

Learning and Skills Council

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

- use the funds in a way consistent with the purposes for which they have been given
 - comply with the conditions attached to those funds.
- 52 The LSC's Chief Executive has arranged to provide himself with assurance in relation to these responsibilities. These arrangements include the work of the LSC's IAD and its Provider Financial Assurance (PFA) Service Centre.
- 53 The LSC's IAD gives annual assurance to the Chief Executive on the overall adequacy and effectiveness of the LSC's risk management, control and governance processes. Part of the LSC's IAD work will be to review the adequacy and effectiveness of the LSC's PFA Service Centre, as one of the LSC's management controls over risk. As part of its review work, the LSC's IAD may occasionally visit providers, in conjunction with the PFA Service Centre's own review programme.
- 54 The national LSC and local LSCs have established audit committees, which advise respectively the Chief Executive and local Executive Directors on the scope and objectives of the work of the PFA Service Centre and its regional teams and on the adequacy and effectiveness of the operation of internal control.
- 55 The LSC's PFA Service Centre is responsible for assurance on the LSC's funding of providers by:
- formulating the LSC's audit requirements for providers
 - receiving, analysing and acting on the results of the work of providers' auditors, where the LSC intends to place reliance upon these results for assurance
 - regional PFA teams carrying out direct assurance work on certain providers' internal control and their application of LSC funds: the frequency and extent of the work depends on risk and materiality
 - directly reviewing the financial management and governance of FE colleges and other significant providers. These reviews are currently on a four-year cycle. The reviews usually take place in parallel with the work of the Office for Standards in Education and the Adult Learning Inspectorate
 - assessing the financial health of all providers (except colleges, which remain the responsibility of the local LSC)
 - monitoring the appointment and the quality of the work of auditors appointed by providers under the LSC's requirements.

The code contains numerous references to the PFA Regional Audit Manager. The list of PFA Regional Audit Managers and their contact details are published on the LSC website

www.lsc.gov.uk/National/Documents/SubjectListing/FundingLearning/ProviderFinance/ProviderFinancialAssurance/Contactdetails.htm).

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

- 56 Many of the LSC's current assurance arrangements for its funding of providers are inherited. This inheritance has led to assurance arrangements that are based on one or more of the following:
- the type of providers funded
 - the form of funding agreement in use
 - the LSC funding stream the provider receives.
- 57 Under the LSC's financial memorandum with the DfES, the LSC must comply with *Government Accounting* published by HM Treasury. In accordance with *Government Accounting*, the LSC uses three types of funding agreement with its providers. These are grant-in-aid, grant, and contract. Each type of funding agreement itself confers different requirements, through *Government Accounting*, on the LSC to obtain assurance.
- 58 The LSC gives grant-in-aid to FE colleges under a financial memorandum. Grant-in-aid funding is assumed to be in perpetuity and is not time-limited, although supporting schedules giving the funds payable are renewed annually. The financial memorandum requires the FE college to appoint an accounting officer. The FE college must only use LSC funds for the purposes granted and all FE college funds, from whatever source, must be used with propriety and regularity, as defined in HM Treasury guidance. Where the FE college holds unspent funding, it may not be distributed outside the FE college. The FE college is restricted in its arrangements for borrowing and acquisition and disposal of significant assets. The FE college must have accounting and audit arrangements that conform with central government norms, including an interest in all aspects of internal control. A simplified financial memorandum is also used for the LSC's funding of dance and drama awards at dance and drama schools.
- 59 The LSC gives grants for specific learning provision. Grants are usually renewed annually, but may be for longer or shorter periods or for the purchase of a specific service. Grant funding confers an interest in the proper use of public funds identical to that for grant-in-aid funding. Depending on the conditions of the grant, unspent funds must be surrendered to the LSC or retained by the provider for future public purposes and in any event not distributed outside the public sector. The terms and conditions of grant agreements are otherwise simpler than a full financial memorandum. The LSC uses various grant agreements with local authorities and independent former external institutions.
- 60 The LSC contracts for learning provision with learning providers from the public, voluntary and commercial sectors. The larger LSC contracts, for the purchase of work-based learning (WBL) provision, will usually be for three years' funding. The LSC also uses short-term contracts for specific learning provision. Many FE colleges and other public bodies currently have contracts in addition to their financial memorandum or grant

agreements. Public sector organizations funded under contract will usually have an overarching requirement given elsewhere to make proper use of public funds, even if this is not explicit in the LSC's contract. Commercial and voluntary organizations funded under contract are not normally restricted in their use of LSC funds, once the LSC is satisfied that the contracted learning provision has occurred and is in accordance with the qualitative and quantitative measures of the contract.

- 61 Given the funding agreements the LSC is required to use, the LSC may seek assurance from providers in any or all of four main areas: financial statements, use of funds, internal control and application of funds. The LSC may require the provider to submit the following.
- Audited “true and fair view” financial statements and related disclosures, including corporate governance statements. For FE colleges, the annual financial statements are essential to their dialogue with the LSC on financial health, forecasting, borrowing and capital projects. For all other providers, the LSC will use financial statements in assessing the providers’ financial health and other analyses.
 - A statement, usually audited, on the provider’s proper use of public funds (the “use of funds” statement). Alternatively, the LSC may seek to obtain this assurance through the work of its own appointed auditors or PFA teams. This assurance, on how LSC funds have been spent, is as described in paragraph 20. In the case of FE colleges, this assurance is obtained through the regularity audit performed by the college’s own financial statements auditors.
 - An audit report on the soundness of the provider’s systems of internal control. Alternatively, the LSC may seek to obtain this assurance through the work of its own appointed auditors or the PFA Service Centre. For FE colleges, the scope of this assurance is on risk management, control and governance processes. For other providers, it will normally be specifically on those systems that support the production of funding claims or spending of LSC funds, or both.
 - In the case of providers not eligible for plan-led funding, a funding claim, based on the FE college or provider’s individual learner records or other statistical return, with an accompanying audit report by the auditors of the provider’s financial statements. Alternatively, the LSC may seek to obtain this assurance through the work of its own appointed auditors or the PFA Service Centre. The funding claim and audit report demonstrate that the provider has earned the funds allocated to it under the LSC’s funding methodology for that provision.
- 62 The LSC takes as much assurance as possible from the work of providers’ existing auditors. The LSC will normally take such assurance where the auditors have been appointed and quality-controlled in

accordance with the requirements of the LSC or another body with a statutory role to secure sound audit arrangements within the public sector (principally the Audit Commission, the NAO or the Higher Education Funding Council for England). Where the LSC cannot ensure the quality of the appointment or the work of providers' existing auditors, it will normally seek to appoint its own auditors. These funding auditors will be either the LSC's PFA Service Centre, or audit firms under contract.

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

Providers' accountability to others

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

Section 3: Specific Audit Requirements on Further Education Colleges

Introduction

- 65 This section of the code applies to FE colleges and specialist designated institutions. FE colleges receive funding from the LSC through grant-in-aid in accordance with the financial memorandum. The term “FE college” does not include adult education institutions and institutions such as specialist providers or dance and drama schools. These institutions are subject to different arrangements, which are considered elsewhere in this code. The term “corporation” refers to college corporations and governing bodies.
- 66 The code retains many of the existing requirements on FE colleges. An immediate reason for this is that FE colleges continue to be funded under a financial memorandum that, under HM Treasury guidance, continues to require these audit arrangements. Many of these arrangements represent normal (if not universal) requirements and practice for central government funding across the UK public sector. Similar long-standing arrangements for internal auditing, auditing of financial statements and audit committees exist for HE institutions, central government bodies, local authorities, the NHS and Housing Associations. Use of internal audit services (IAS) and audit committees is increasingly seen as best practice in voluntary and commercial sector organizations.
- 67 This section of the code sets out audit requirements of FE colleges at length, in contrast with the relatively brief sections on other providers and funding streams. This is acknowledged and is a product of the LSC’s effective status as “regulator” of the financial accountability of FE colleges. The other parts of the public sector listed above have their own statutes, codes or equivalent documents, on which the LSC normally relies, setting out their requirements in similar vein. These other codes are not reproduced here. Providers outside the public sector are subject to Companies Acts or Charity Commission requirements or other regulations, none of which are reproduced here.

Sources of requirements on further education colleges

Further education college articles of government

- 68 The articles of government for FE colleges require corporations to:
- establish an audit committee to advise on matters relating to the corporation’s audit arrangements and systems of internal control. The committee shall consist of at least three persons and may include employees of the corporation (as noted in paragraph 27 above, “corporation” should be taken to mean college corporation or governing body), other than those in senior posts, and shall operate in accordance with any requirements of the LSC (article 5 (5))

- cooperate with any person authorized by the LSC to audit any returns of numbers of learners or claims for financial assistance and give any such person access to any documents or records held by the corporation (article 18, or 17 for sixth form colleges)
- arrange for the examination and evaluation on its behalf of its systems of internal financial control to ensure that they contribute to the proper, economical, efficient and effective use of the corporation's resources (article 19 (1)). The persons appointed are referred to as "internal auditors" (article 19 (2), or article 18 (1) and (2) for sixth form colleges)
- appoint for each financial year a financial statements auditor (or external auditor) (article 20 (3), or article 19 (3) for sixth form colleges)
- not appoint any persons as internal auditors who are appointed as financial statements auditors (article 20 (5), or article 19 (5) for sixth form colleges).

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

Financial memorandum

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

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

the FE college's income, assets and expenditure (paragraph 12). As the FE college's accounting officer, the principal may be required to appear before the Committee of Public Accounts of the House of Commons, alongside the Chief Executive of the LSC, on matters relating to the use of funds provided by the LSC (paragraph 14).

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

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

Audit committee

Role

- 71 The role of the audit committee is advisory. Each FE college must establish an audit committee to advise on the adequacy and effectiveness of the FE college's systems of internal control and its arrangements for risk management, control and governance processes. This advice is primarily formed through a consideration of the work of the FE college's IAS and its financial statements auditor. Guidance on risk management is provided in the LSC's *A Guide to Risk Management in Further Education*, available on the LSC website (www.lsc.gov.uk/National/Documents/SubjectListing/FundingLearning/ProviderFinance/ProviderFinancialSupport/RM_in_FE.htm).
- 72 To establish the role of the audit committee, the corporation must set terms of reference for the audit committee. Minimum terms of reference to be used are detailed in Annex B in Supplement B to this Code. While the corporation may add to these terms of reference, it must not add terms that:

- require the audit committee to adopt an executive role
 - require members of the audit committee to offer professional advice to the corporation outside their role as governors; or
 - cause the committee to lose its primary focus on the adequacy and effectiveness of the FE college's audit arrangements and risk management, control and governance processes.
- 73 The corporation's approval of the FE college's annual financial statements must be on the recommendation of the audit committee or the finance committee or both committees. Where the corporation approves the financial statements on the recommendation of the finance committee, the audit committee must also receive the financial statements to inform their review of the management letter of the financial statements auditor and consideration of the statement on corporate governance (including assurance that the college has spent its funds with propriety and regularity).
- 74 The audit committee must have the right of access to obtain all the information it considers necessary from members of the staff and governors, and to consult the IAS and financial statements auditor (and funding auditor if one is appointed) directly.

Membership and clerking

- 75 Paragraph 5 of the articles of government and paragraph 10 of the financial memorandum set the requirements for audit committee membership. In order to ensure independence and objectivity, members of the audit committee must not be members of the finance committee (or equivalent) and the chair of the corporation must not be a member of the audit committee.
- 76 The corporation must determine the membership of the audit committee and the terms on which they are to hold and vacate office. A coopted external member of the audit committee should not normally be appointed as its chair, since the chair has to be able to attend, as of right, all meetings of the corporation. Subject to this, coopted external members should be treated as having equivalent status to full members of the corporation.
- 77 To maximize the independence of the audit committee, the clerk to the corporation should normally be the clerk to the audit committee. Where the clerk to the corporation is a senior manager at the FE college or has significant financial responsibility, another individual should act as clerk to the audit committee so as to protect the independence and objectivity of the audit committee.

Operation

- 78 The audit committee must have the right, whenever it is satisfied that it is appropriate to do so, to go into confidential session and exclude any, or all, participants and observers, except the clerk to the audit committee.

When the audit committee exercises this right, the rules relating to quoracy must be observed.

- 79 The internal auditor must be invited to attend all meetings, as must the financial statements auditor (and funding auditor where one is appointed) where business relevant to them is being discussed. Senior management should be invited to attend audit committee meetings, particularly where their area of responsibility is under discussion.
- 80 The audit committee must consider all significant audit findings or recommendations but need not be concerned with the more detailed findings unless the audit committee considers this valuable. The corporation, advised by the audit committee, is ultimately responsible for ensuring that management takes appropriate action on those reports that call for it, or for recognizing and accepting the risks of management not taking action.

Annual cycle of business

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

Table 1: Minimum cycle of audit committee business.

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

11	Recommendation of approval to the corporation of annual financial statements (may be the role of the finance committee or equivalent) including regularity audit opinion.					✓		Yes
12	Funding auditor final opinion and management letter (where applicable).						✓	Yes
13	Review of performance of the financial statements auditors and establishment of annual performance indicators for the following year.						✓ or summer term	No
14	Internal audit reports on reviews and progress update.	Depends on timing of reports						No
		✓	✓	✓				
15	Consideration of funding auditor franchise and partnership spot-check reports (where applicable).	Depends on timing of visits						No
		✓	✓	✓				

Notes to Table 1

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

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

Internal audit service

- 82 Both the articles of government and the financial memorandum require the corporation of each FE college to establish an internal audit service (IAS).
- 83 Parts of the code are common to IASs and financial statements auditors. These parts are dealt with at paragraphs 81 to 104 of the code. The IAS must comply with the requirements of the code.

Standards

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

Role

- 85 Internal audit is defined in the GIAS as being “an independent and objective appraisal service within an organization.
- “The IAS primarily provides an independent and objective opinion to the corporation on risk management, control and governance processes, by measuring and evaluating their effectiveness in achieving the organization’s agreed objectives. In addition, internal audit’s findings and recommendations are beneficial to line management in the audited areas. Risk management, control and governance comprise the policies, procedures and operations established to ensure the achievement of objectives, the appropriate assessment of risk, the reliability of internal and external reporting and accountability processes, compliance with applicable laws and regulations, and compliance with the behavioural and ethical standards set for the organisation.
 - “Internal audit also provides an independent and objective consultancy service specifically to help line management improve the organization’s risk management, control and governance. The service applies the professional skills of internal audit through a systematic and disciplined evaluation of the policies, procedures and operations that management put in place to ensure the achievement of the organization’s objectives, and through recommendations for improvement. Such consultancy work contributes to the opinion which internal audit provides on risk management, control and governance.”
- 86 The introduction and maintenance of risk management and control processes in FE colleges is a management function. The IAS cannot provide any guarantee against material errors, loss or fraud. The IAS can play a valuable role in helping management to improve risk

management, control and governance processes and so reduce the potential effects of any significant risks faced by the FE college.

Scope of internal audit service

- 87 The IAS must have formal terms of reference, agreed by the corporation on the recommendation of the audit committee. These must include the terms of reference set out in Annex D to Supplement B. FE colleges may accept other terms and conditions of business but these must not compromise or conflict with the terms of reference given at Annex D.
- 88 While the LSC does not specify what level of coverage of learner number systems college internal auditors should adopt, colleges will wish to ensure that there is appropriate coverage of learner number systems by their internal auditors, or that they have some alternative form of assurance in place over their learner number systems. Colleges may appoint additional audit or other consultancy work to this end. Where this has taken place, colleges should encourage internal auditors to rely on consultancy work. Learner number systems are major systems in most colleges and will be the basis of monitoring plans and in that respect will be fundamental to the trust relationship.
- 89 Each FE college must devote sufficient resources to the IAS, taking into account the advice given by the head of the IAS. If the head of the IAS or the audit committee considers the level of audit resources limits the scope of the IAS or prejudices the ability of the IAS to deliver a service consistent with the definition of internal auditing, they must draw this matter to the attention of the corporation. Where agreement cannot be reached on the level of IAS resources, the FE college must report this to the LSC's PFA Regional Audit Manager.

Independence

- 90 The IAS must be sufficiently independent of the activities it audits to allow auditors to form impartial and effective professional judgements and recommendations. The IAS must be separate from FE college management, even if provided in-house, and without any executive, management or operational responsibilities outside the IAS.
- 91 Individual internal auditors must not be assigned to assurance work in areas where they have had an executive or other involvement for at least two years after such involvement.

Relationships with management, other auditors and other review bodies

- 92 The head of the IAS must coordinate IAS plans and activities with FE college managers, financial statements auditors and funding auditors (where appointed) to ensure the most effective audit cooperation is achieved and duplication of effort is minimized. The IAS must offer the financial statements auditors the opportunity to place reliance on their work, provided this does not prejudice the IAS's independence.

Staffing, training and development

- 93 The IAS must demonstrate compliance with the four principles of the Code of Ethics for Internal Auditors set out in the GIAS. The principles cover integrity, objectivity, competency and confidentiality.
- 94 The IAS must be appropriately staffed in terms of numbers, grades, qualification levels and experience to fulfil its objectives in accordance with the GIAS. All internal auditors must be properly trained to carry out their responsibilities and must undertake a programme of continuing professional development. The head of the IAS must either hold the Government Internal Audit Certificate (GIAC) or be able to demonstrate skills, knowledge and experience consistent with the requirements needed for the GIAC, as must the person leading the IAS work.

Audit strategy

- 95 The head of the IAS must develop and maintain a strategy for providing the corporation with an objective evaluation of the FE college's risk management, control and governance processes, and opinions on their effectiveness.
- 96 The strategy must be developed to meet the audit needs of the FE college as assessed by the head of the IAS, using the FE college's objectives and risk management as a primary resource. The IAS must develop, as a minimum, a strategic audit approach that over the cycle of the strategy covers all the areas listed in Annex C to Supplement B. FE colleges will be able to commission audit work from their IAS to cover other risk areas identified by the IAS at the planning stage or by the FE college's own risk assessment process.
- 97 The IAS must prepare annual audit plans designed to implement the audit strategy. The FE college must receive from its IAS timely strategic and annual plans formulated according to the IAS's own priorities. The plans must be approved, before the commencement of work, by the corporation on the recommendation of the audit committee, and must cover the whole year.

Management of audit assignments

- 98 For each audit assignment, a detailed plan must be prepared. The IAS must seek a sponsor for each assignment. This will normally be the FE college manager with overall responsibility for the area to be audited. Assignment plans must be agreed with the sponsor before any work is done.
- 99 The IAS must adopt a risk-based systematic approach, as set out in GIAS, for all audit assignments intended to provide an opinion. This approach will enable the IAS to reach the conclusions necessary to form an opinion on the area being reviewed. Such opinions must be clearly stated in assignment reports. Audit opinions can also be derived by the use of supplementary audit techniques and approaches.
- 100 The IAS must follow up assignments by reviewing the effectiveness of the response of the FE college's management to the findings and recommendations of assignments. The follow-up findings must be reviewed with the sponsor before being reported. The head of the IAS

must report to the audit committee any management responses that they judge to be inadequate for the identified risk.

Reporting

- 101 A written audit report must be issued at the close of each audit assignment. It is the head of the IAS's responsibility to alert the audit committee how far the corporation could be exposed by any shortcomings in the area under review. The degree of control must be related to the risks involved, but it is management's role to exercise judgement in establishing the balance between risk and control.
- 102 The IAS must produce an annual report on its opinion of the overall adequacy and effectiveness of the FE college's risk management, control and governance processes, within the scope of its review. The minimum content for an FE college IAS annual report, which must be followed by the IAS, is set out in Annex E to Supplement B. Each FE college must promptly provide a copy of the approved annual IAS report to the LSC's PFA Regional Audit Manager, following its consideration by the audit committee.

Quality assurance

- 103 The work of the IAS must be controlled at each level of operation to ensure that a continuously effective level of performance, complying with the GIAS, is being maintained. The head of the IAS must develop a quality-assurance programme designed to give assurance that the work of the IAS complies with the GIAS.
- 104 The head of IAS must make provision for internal quality reviews of the work at the FE college to be undertaken periodically by appropriately experienced or qualified individuals. These reviews must be undertaken at least every other year.

Financial statements auditor

Role

- 105 The basic objective of the FE college financial statements auditor is to report on the truth and fairness of the income and expenditure for the year, and the financial position of the FE college and any subsidiary companies shown in the financial statements. The financial statements auditor must form an opinion as to whether proper accounting records have been kept and whether the accounts are in agreement with those records, and to state that the accounts have been properly prepared in accordance with the Statement of Recommended Practice: Accounting for Further and Higher Education Institutions.
- 106 The financial statements auditor must also be concerned with the requirements of the LSC to report on the regularity and propriety of transactions. The financial statements auditor must report, in all material respects, whether monies expended out of funds from whatever source administered by the FE college for specific purposes have been properly applied for those purposes and that monies expended out of funds

provided by the LSC (and the Higher Education Funding Council for England (HEFCE) if applicable) have been applied in accordance with the financial memorandum (and the funding agreement with HEFCE if applicable) and any other terms and conditions attached to the funding. The financial statements auditor is required to follow the standards set in the audit framework and programme provided by the LSC for the purposes of providing a specific opinion on the regularity and propriety of the college's expenditure. Audit programmes will be published on the LSC website and standards will be monitored through a quality-assurance process.

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

Letter of engagement

- 108 The corporation must appoint the financial statements auditor. The appointment will be subject to annual review and reappointment. The duties of the financial statements auditor must be clearly presented in an engagement letter. The LSC will be a party to this engagement for that part of the engagement leading to the opinion on colleges' regular and proper use of LSC and other funds (the regularity audit). As a party to the engagement, the LSC is able to set standards for regularity audit work and monitor compliance with those standards. Monitoring compliance will, as far as possible, make use of peer review between firms, as successfully operated by the LSC and firms appointed by the LSC to carry out funding audit. There will be a letter of engagement between the college and the financial statements auditor that will refer to the duty of care owed to the LSC by the auditor in respect of regularity audit. There will be a second letter between the financial statements auditor and the LSC giving a formal duty of care over the regularity audit work at all of their client colleges.
- 109 The duty of care owed by financial statements auditors in respect of regularity audit is not yet resolved. The model engagement letter with colleges which must be followed by the financial statements auditors is still being developed and will be issued separately. The LSC will review the wording of the letter of engagement every year. FE colleges may accept terms and conditions of business as part of the letter of engagement but these must not compromise or conflict with the terms of reference given in the model engagement letter.

Reporting arrangements

- 110 The financial statements auditor has no responsibility for auditing or undertaking any detailed work on the FE college's funding claims. Under plan-led funding, the LSC will continue to issue a statement of funds to

colleges, for the financial statements auditors to rely on as part of their audit. The arrangements for this are still being developed. Those colleges not eligible for plan-led funding will continue to have a detailed funding audit. Arrangements for funding audit at colleges not eligible for plan-led funding are described in Annex F to Supplement B.

- 111 In common with all public bodies, the LSC is subject to HM Treasury's Faster Closure Agenda. This agenda requires the LSC to place its audited annual financial statements before Parliament, prior to Parliament rising for its summer recess, typically in July each year.
- 112 The new reporting timetable will apply to the LSC's financial year ending 31 March 2006. The LSC will therefore require regularity auditors to deliver an interim opinion to 31 March 2006 as well as a final report to 31 July 2006. The year 2004-05 will be a transitional year. In summary, the timing of the work would be as shown in Table 2.

Table 2: Timetable of audit work 2004-05 to 2005-06.

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

	September or October 2006	Financial statements auditors audit college financial statements for the year ended 31 July 2006 and update regularity audit to 31 July 2006.
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Audit report

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

Management letter

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

Eligibility

- 116 The criteria required for eligibility as financial statements auditors of FE corporations are set out in paragraph 5b) of Schedule 8 of the Further and Higher Education Act 1992 and included in the list of key definitions at Annex H to Supplement B.
- 117 A number of financial statements auditors have transferred their business into a limited liability partnership (LLP) formed under the Limited Liability Partnership Act 2000. Under the previous partnership arrangements, the partnership did not have a separate legal status from that of its individual members. The effect of the transfer to an LLP is to establish corporate bodies that constitute a separate legal entity from their members. In practice, this will make no difference to the FE college as the rights and the liability of the new corporate body will remain the same.

Funding auditor

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

Areas common to the internal audit service and financial statements auditor

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

Selection criteria and procedures

- 120 On joining the FE sector, or when mergers occur, FE colleges must have in place an IAS and financial statements auditor with effect from the first day of operation of their financial memorandum with the LSC. FE colleges already funded by the LSC have in place both sets of auditors, and can periodically seek to confirm or change their audit service providers. If the audit service provider is changed, the contract with the incoming provider must start on the day after expiry of the contract with the outgoing provider to ensure continuity of provision. Where continuity is not possible, for example, due to the immediate resignation of the incumbent auditors, the FE college must institute interim arrangements before commencing the formal appointment process. Such a period should not normally exceed three months. If the FE college believes that a gap is unavoidable, they must contact their PFA Regional Audit Manager.
- 121 Each corporation must, in accordance with the financial memorandum with the LSC, appoint an IAS and a financial statements auditor in accordance with the LSC's requirements. Corporations should also follow the college's own financial regulations for making such appointments. The PFA Regional Audit Manager will advise FE colleges on audit appointments in advance of the FE college's selection process, on request. FE colleges must promptly send to the PFA Regional Audit Manager the draft letter of engagement for the audit provider the FE college plans to appoint so that the LSC can ensure it is in accordance with its requirements.
- 122 An audit service provider proposing to accept the appointment as internal auditor or financial statements auditor must obtain the FE college's permission to communicate with the outgoing auditors. Outgoing auditors must obtain permission from the FE college to discuss its affairs freely with the proposed auditors, and must disclose all information required by the proposed auditors that is relevant to the appointment.
- 123 Where the IAS is contracted to an external provider, the head of the IAS must be rotated every seven years. The partner responsible for the financial statements audit must also be rotated every seven years. The IAS must annually ensure that appropriate arrangements are in place to guarantee the independence of internal audit.
- 124 FE colleges must promptly send details to the PFA Regional Audit Manager of a significant change of audit service provider, whether by merger, demerger, takeover or other significant reorganization.

Auditors' liability

- 125 FE colleges must not appoint a financial statements auditor whose letter of engagement includes any limitation of liability in respect of external audit work. The limitation might be through an explicit clause or by other limitation of liability. This principle matches that of section 310 of the Companies Act 1985, which prohibits any capping of the auditors' liability in respect of audit opinions given under that Act.
- 126 For internal audit work, FE colleges can negotiate over any proposal by the IAS to restrict or cap its liability. The corporation must specifically consider and approve any request for a liability restriction. This limit must not be under £1 million.
- 127 For categories of work other than the certification of financial statements, or internal audit work, FE colleges may negotiate with their audit service provider over any proposal by them to restrict or cap their liability as long as the eventual outcome represents the best value for money and takes into account the wider interests of the FE college, the LSC, the DfES and taxpayers. It should also take into account the risks and likely consequences of any loss suffered as a result of negligence, the effect of the terms of any restriction of liability and the level of professional indemnity held. The corporation must specifically consider and approve any request for a liability restriction.

Removal or resignation of auditors

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

Due professional care

- 129 Auditors must exercise due professional care in their work, but the concepts can be explained separately. "Due care" means working with competence and diligence, not infallibility or extraordinary performance. Auditors are not expected to give absolute assurance. "Professional care" means using audit skills and judgement based upon appropriate experience, training, ability, integrity and objectivity. "Professional care" must be appropriate to the objectives, complexity and materiality of the audit being performed.
- 130 In exercising due professional care, auditors must:
- take reasonable steps to obtain information relevant to the audit: auditors should take into account information from the FE college, the LSC, any changes in legislation and the results of previous audit work
 - keep up to date with developments in professional matters
 - look out for and take into account any unusual circumstances

- consider audit objectives and plan work to adhere to them
- document the conclusions arising from the planning process, and detail a budget for staff and time
- discuss the main features of the audit with the FE college
- ensure that audits are staffed with suitably qualified and experienced personnel, and that work is properly controlled and reviewed
- ensure that conclusions are adequately supported by reliable evidence. This evidence should be sufficient for an experienced auditor with no previous connection with the audit to ascertain what work was done and how the conclusions were reached
- control costs of audit, and weigh costs and likely benefits
- preserve confidentiality where appropriate.

Access

- 131 The IAS, the financial statements auditor and (where appointed) the funding auditor must have unrestricted access to all documents, records, assets, personnel and premises and be authorized to obtain such information and explanations as they consider necessary for their work.
- 132 Each FE college must grant the head of internal audit, the financial statements auditor and (where appointed) the funding auditor, the right of access to the chair of the audit committee and also the right to ask the chair to convene a meeting, if necessary with, or without, other participants. The head of the IAS must have direct access to the principal and to the corporation, normally through the chair of the audit committee.

Additional services

- 133 The corporation must approve additional services beyond the scope of the auditors' terms of reference, where the cumulative value of this work by any of the audit service providers exceeds £20,000 in any 12-month period. The corporation may choose to adopt a lower threshold for its approval. The audit committee must be informed of all work undertaken by FE college auditors.
- 134 The corporation and the auditors must ensure that additional services do not compromise the audit service providers' objectivity, independence or ability to achieve audit plans. All work, regardless of value, where there is a possible conflict of interest must be referred to the corporation to enable it to form a view on it.

Fraud and irregularity

- 135 The financial statements auditor of each FE college has a duty to plan and conduct the audit so that there is a reasonable expectation of detecting material mis-statements in the accounts arising from irregularities, including fraud, or breaches of regulations. The financial

statements auditor does not have a duty to search specifically for irregularities and fraud and their audit should not be relied upon to disclose them. Where the financial statements auditor identifies a serious weakness or an accounting or other control breakdown it must be reported to the principal, the chair of the corporation and the chair of the audit committee without delay.

- 136 The head of the IAS must issue written procedures to auditors on the action to be taken if they suspect or discover fraud or irregularity and must arrange to be informed by the FE college, as soon as possible, of all suspected or discovered fraud, whether internal or external. The principal and chair of the audit committee must also be informed. Where the audit committee feels there is evidence of irregularity, fraud, corruption or any impropriety, the chair of the audit committee must notify the chair of the corporation, who must raise the matter at the next meeting of the corporation. Where the matter is considered significant, the governors must consider holding a special meeting.
- 137 All FE colleges must have a written policy on the process to be followed when evidence of potential irregularity, including fraud, corruption or any impropriety, is discovered. The policy must include referral to the audit committee and the commissioning by the audit committee of special investigations by the IAS or others. This must be set out in the FE college's financial regulations or specified separately in a fraud policy statement. The head of the IAS must also be informed so that he or she can consider the adequacy of the relevant controls, evaluate the implication of the fraud on the risk management, control and governance processes and consider making recommendations as appropriate.
- 138 The FE college, and where appropriate (subject to the requirements of the Proceeds of Crime Act 2003), its funding auditor (if appointed), its financial statements auditor or its IAS must report to the LSC's Chief Executive, and copy to the local LSC's Executive Director, without delay, serious weaknesses, significant frauds, major accounting and other control breakdowns of which they are aware. A serious weakness would be one which may result in a significant fraud or irregularity, and may include cases of irregularities in expenditure which could lead to suspicions of fraud. Significant fraud is usually where one or more of the following factors are involved.
- The sums of money are in excess of £10,000.
 - The particulars of the fraud are novel, unusual or complex.
 - There is likely to be great public interest because of the nature of the fraud or the people involved.
- 139 There may be circumstances that do not fit this definition. In these cases or any others, advice or clarification can be sought from the PFA Regional Audit Manager.

Access to further education colleges and audit working papers

- 140 FE colleges must allow the LSC, the DfES's internal auditors and the NAO unrestricted access to all records, information and assets which they consider necessary to fulfil their responsibilities, including, through the FE college's contract with the IAS, IAS working papers and key IAS personnel.
- 141 Internal audit working papers may be the property of the FE college. The Institute of Chartered Accountants in England and Wales has issued a technical release *Audit 2/98 Access to the Working Papers on Internal and Financial Statements Auditors of FE Colleges* which provides guidance on access to working papers and examples of hold harmless letters. The example hold harmless letters allow the LSC or the financial statements auditors or the FE college's new IAS access to the IAS working papers.
- 142 The college financial statements auditors must comply with any requests from the LSC, the DfES's internal auditors and the NAO for access to any information which they consider necessary to fulfil their responsibilities. The working papers are the property of the financial statements auditor.

Section 4: Local Authorities

Introduction

- 143 This section sets out, for information, the LSC's general approach to assurance for its funding of learning provision delivered through local authorities and/or local education authorities (LEAs).
- 144 The LSC's assurance arrangements do not affect the statutory requirements of local authorities in respect of the audit of their financial statements or the internal audit of their internal control. These requirements are not within the LSC's remit. The overarching requirements on local authorities and the role of the Audit Commission are set out at Annex G to Supplement B. The LSC's assurance arrangements are currently organized by funding stream.

Specific assurance arrangements

- 145 Local authorities are principally funded by the LSC through grant for the following.
- School sixth form funding: delivered principally through schools maintained by the LEA. Some learning provision for pupils with special educational needs is subcontracted by the LEA to independent schools. The LSC obtains assurance from auditing pupil numbers and qualification aims at a minimal sample of schools annually. The LSC appoints and pays local authority internal auditors to perform the work on the LSC's behalf and report to the LSC. This avoids introducing a further set of auditors of schools.
 - Adult and community learning: delivered by local authorities direct, by assignment to adult education institutions or schools maintained by the local authority, or by subcontract to other organizations. The LSC requires LEAs as a condition of grant to make a return to the LSC on their use of LSC adult and community learning funds, as set out in an annual circular, accompanied by a certificate from the LEA auditors, appointed by the Audit Commission. It is anticipated that this assurance arrangement will be retained as long as local authorities continue to receive block funding from the LSC, under adult and community learning or its possible replacements.
 - FE education participation and learner support: delivered principally by LEA-maintained former external institutions. The LSC's assurance arrangements for LEA-maintained former external institutions are set out in annual circulars. The LSC requires all former external institutions to make final funding claims to the LSC: in addition, LEAs are required to provide an audited use of funds statement on behalf of all their former external institutions. The claim and statement on use of funds must be accompanied by a certificate by the auditor appointed by the Audit Commission to audit the accounts of the local authority, as described in Annex G to Supplement B. As with FE

colleges, former external institutions are in scope for plan-led funding for 2004/05: approximately half of former external institutions are eligible for plan-led funding for 2004/05. The current rules in respect of funding audit will apply for those FE institutions not eligible for plan-led funding. former external institutions that are eligible for plan-led funding will not be subject to a funding audit. All LEA-maintained former external institutions are already subject to a regularity audit by the Audit Commission and this will remain for all. Detailed assurance arrangements will be set out in the annual circular for 2004/05.

- Excellence Challenge: under a funding agreement devised by the DfES, delivered by schools. Assurance arrangements for these funds are under consideration.

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

Section 5: Other Providers and Funding Streams

Introduction

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

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

Audit arrangements led by funding agreement

Work-based learning

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

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

Other contract-based funding

150 The LSC funds significant values of learning provision through funding streams including local initiative funding, workforce development, adult IAG and education business links. There are also many other funding streams, with lower financial values, not listed here. Each of these funding streams is subject to a separate funding agreement that each provider receives. Each funding agreement, as for WBL, sets out the audit arrangements required of the provider. The LSC's PFA Service

Centre, or its appointed contractors, will give assurance on these funding agreements as for WBL. Where possible, the LSC's PFA Service Centre will plan its work to cover all of a provider's contract-based funding as part of a single review.

- 151 The LSC is piloting in 2004/05 how it can bring its funding of WBL at FE commercial and voluntary sector providers within the scope of plan-led funding. Doing this will require these providers to be funded under grant and not contract and hence the providers will be required to make regular and proper use of LSC funds. While the LSC funding audit will no longer be required, it will be replaced by a regularity audit that will be new to these providers. The LSC needs to explore with providers the benefits and costs of such a change.
- 152 The LSC is the final beneficiary of a significant amount of European Social Funding (ESF). It is seeking to match most of this funding as co-financing of learning provision at both existing and new learning providers. The LSC will seek to perform assurance work on matched ESF as part of its normal assurance work on these providers' other funding. In some cases where the principles of co-financing do not apply, the LSC may require an audit of the costs of ESF provision. The assurance requirements over ESF are those set by the European Commission and the LSC has effectively no influence over these requirements.

Audit arrangements led by provider type

Higher education institutions

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

Specialist providers

- 154 The LSC funds learners with learning difficulties and/or disabilities through individual placements, under schedule and purchase order, at specialist providers. Under these arrangements, the specialist provider's financial statements auditor must provide a statement on the use of LSC funds to the LSC within six months of the end of its financial year. The LSC's assurance arrangements for this funding have been redeveloped in association with the National Association of Specialist Colleges (NATSPEC) on behalf of its member specialist providers. Where

agreement has been reached with individual specialist providers, whether members of NATSPEC or not, for the LSC's PFA Service Centre to perform funding audit at the provider, there will no longer be a requirement for their financial statements auditor to provide a statement on the use of LSC funds.

Independent former external institutions

- 155 The LSC funds FE participation and related funds at a small number of independent former external institutions. These institutions will until further notice be subject to the same assurance arrangements as LEA-maintained former external institutions. Audit reports on the independent former external institutions' funding claims are, however, provided by the institutions' financial statements auditors.
- 156 As with FE colleges, former external institutions are in scope for plan-led funding for 2004/05: approximately half of former external institutions are eligible for plan-led funding for 2004/05.

Ufi/learndirect hubs

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

Dance and drama schools

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

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

Central government bodies

- 159 The LSC funds a number of central government bodies, mainly for WBL. The LSC will be exploring whether reciprocal assurance arrangements can be established for this funding with the other bodies. Where such arrangements are not established, the LSC's PFA Service Centre will

provide assurance. As described in paragraph 23 above, public sector bodies receiving LSC funding under contract will be subject to an overarching requirement set out elsewhere to make proper use of these public funds. The LSC's PFA Service Centre will not review the proper use of public funds by central government bodies receiving WBL funding.

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Supplement B to Circular 04/07

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Further information

For further information, please contact:

Provider Financial Assurance Service Centre

Learning and Skills Council

Cheylesmore House

Quinton Road

Coventry

CV1 2WT

Tel: 024 7649 3993

Website:

www.lsc.gov.uk/National/Documents/SubjectListing/FundingLearning/ProviderFinance/ProviderFinancialAssurance

Director, Assurance Policy

Louise Mellor

Learning and Skills Council

St Lawrence House

29–31 Broad Street

Bristol

BS99 7HR

Tel: 0117 372 6518

Email: louise.mellor@lsc.gov.uk

Regional Audit Manager (London)

Steve Passmore

Learning and Skills Council

Centre Point

103 New Oxford Street

London

WC1A 1DR

Tel: 020 7904 0788

Email: steve.passmore@lsc.gov.uk

Contact details for Regional Audit Managers can be found on the LSC website (www.lsc.gov.uk/National/Documents/SubjectListing/FundingLearning/ProviderFinance/ProviderFinancialAssurance/Contactdetails.htm).

Annex A: Mandatory Audit Requirements on Further Education Colleges

160 This index references the mandatory requirements for further education (FE) colleges and their auditors, as set out in the Learning and Skills Council (LSC) Audit Code of Practice (the code). Audit requirements of the articles of government and the financial memorandum are given in paragraphs 30 and 31 of the code.

Table 1: Mandatory requirements for FE colleges and their auditors.

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Annex B: Minimum Terms of Reference for a Further Education College Audit Committee

- 1 As a minimum, the terms of reference for an FE college audit committee must include the following responsibilities:
 - to advise the governing body on the adequacy and effectiveness of the FE college's systems of internal control and its arrangements for risk management, control and governance processes, and securing economy, efficiency and effectiveness (value for money)
 - to advise the governing body on the appointment, reappointment, dismissal and remuneration of the financial statements auditor and the internal audit service (IAS)
 - to advise the governing body on the scope and objectives of the work of the IAS, the financial statements auditor and the funding auditor (where appointed)
 - to ensure effective coordination between the IAS, the funding auditor (where appointed) and the financial statements auditor, including whether the work of the funding auditor should be relied upon for internal audit purposes
 - to consider and advise the governing body on the audit strategy and annual internal audit plans for the IAS
 - to advise the governing body on internal audit assignment reports and annual reports and on control issues included in the management letters of the financial statements auditor (including their work on regularity) and the funding auditor (where appointed), and management's responses to these
 - to monitor, within an agreed timescale, the implementation of agreed recommendations relating to internal audit assignment reports, internal audit annual reports, the funding auditor's management letter and spot-check reports (where appropriate) and the financial statements auditor's management letter
 - to consider and advise the governing body on relevant reports by the National Audit Office (NAO), the Learning and Skills Council (LSC) and other funding bodies, and, where appropriate, management's response to these

- to establish, in conjunction with FE college management, relevant annual performance measures and indicators, and to monitor the effectiveness of the IAS and financial statements auditor through these measures and indicators and to decide, based on this review, whether a competition for price and quality of the audit service is appropriate
 - to produce an annual report for the governing body and accounting officer, which should include the committee's advice on the effectiveness of the FE college's risk management, control and governance processes, and any significant matters arising from the work of the IAS, the funding auditors (where appointed) and the financial statements auditor
 - to ensure that all allegations of fraud and irregularity are properly followed up
 - to be informed of all additional services undertaken by the IAS, the financial statements auditors and the funding auditors (where appointed).
- 2 If the governing body decides to approve the financial statements on the advice of either the audit committee or the audit committee and the finance committee, the following term of reference can be added:
- to recommend the annual financial statements to the governing body for approval.

Annex C: Business Areas for Inclusion in Internal Audit Strategic Plans

- 1 To assist audit committees and internal audit providers, the business areas set out below must, where applicable, be included as a minimum within FE colleges' internal audit plans.

To be included in annual plans:

- the operation of governance processes
- the operation of risk management processes.

To be included in strategic (that is, over a three- to five-year period) plans:

- long-term planning, including formulating bids for allocations from the LSC and non-LSC funding
- learner number systems and funding claims
- financial planning, budget-setting, monitoring and forecasting
- fundamental financial accounting and asset controls
- significant partnerships, including FE college subsidiary or associated companies, franchising, joint ventures and subcontracted direct learning provision
- procurement and payments
- capital project planning, management and evaluation
- security of the IT infrastructure and disaster recovery
- contractors of the FE college who provide any service that handles or processes FE college finances or FE college management information in any form
- personnel, the appointment and departure of staff and senior postholders who are full time or part time, the payment of salaries, wages and other staff payments.

Annex D: Minimum Terms of Reference for Further Education College Internal Audit Services

- 1 The internal audit service (IAS) is responsible for conducting an independent appraisal of all the FE college's activities, financial and otherwise. It should provide a service to the whole FE college, including the governing body and all levels of FE college management. It is not an extension of, nor a substitute for, good FE college management, although it can have a role in advising FE college management. The IAS is responsible for giving assurance to the FE college's governing body and principal on the adequacy and effectiveness of the FE college's risk management, control and governance processes. The IAS assists FE college management by evaluating and reporting to it the effectiveness of the controls for which it is responsible. This work contributes to the opinion that the IAS provides on risk management, control and governance processes. It remains the duty of FE college management, not the IAS, to operate adequate systems of risk management, control and governance. It is for FE college management to determine whether or not to accept audit recommendations and to recognize and accept the risks of not taking action.

Appointment

- 2 The IAS is appointed by the governing body for a term of [x] years commencing [xxxx]. This is subject to satisfactory annual performance evidenced by annual review by the audit committee and recommendation to the governing body. Remuneration shall be fixed by the governing body on the advice of the audit committee.

Scope

- 3 All the FE college's activities, funded from whatever source, fall within the remit of the IAS. The IAS may consider the adequacy of controls necessary to secure propriety, economy, efficiency and effectiveness in all areas. It will seek to confirm that FE college management has taken the necessary steps to achieve these objectives and manage the associated risks. The scope of the IAS's work shall cover operational and FE college management controls and should not be restricted to the audit of systems and controls necessary to form an opinion on the financial statements. As a minimum, the scope of work shall cover the business areas set out in Annex C in Supplement B to the Audit Code of Practice. The IAS shall devote particular attention to any aspects of risk management, control and governance processes affected by material changes to the FE college's risk environment.

- 4 The systems of control subject to the IAS's work shall include those systems of control operated by:
- all FE college subsidiary or associated companies
 - the FE college's partners in franchised learning provision
 - joint ventures
 - subcontracted direct learning providers
 - contractors of the FE college who provide any service that handles or processes FE college finances or management information in any form.
- 5 It is not within the remit of the IAS to question the appropriateness of policy decisions. However, the IAS is required to examine the arrangements by which such decisions are made, monitored and reviewed.
- 6 [This paragraph should be inserted if the corporation agrees.]The IAS may also conduct any special reviews requested by the governing body, audit committee or principal, provided such reviews do not compromise the IAS's objectivity or independence, or the achievement of the approved audit plan.

Responsibilities

- 7 The head of the IAS is required to give an annual opinion to the governing body, through the audit committee, on the adequacy and effectiveness of the FE college's risk management, control and governance processes. He or she should also comment on other activities for which the governing body is responsible, and to which the IAS has access.
- 8 The IAS fulfils its terms of reference through review and evaluation of risk management, control and governance processes. These comprise the policies, procedures and operations in place to:
- establish and monitor the achievement of the FE college's objectives
 - identify, assess and manage the risks to achieving the FE college's objectives
 - advise on, formulate and evaluate policy, within the responsibilities of the principal as accounting officer
 - ensure the economical, effective and efficient use of resources
 - ensure compliance with established policies, procedures, laws and regulations
 - safeguard the FE college's assets and interests from losses of all kinds, including those arising from fraud, irregularity and corruption

- ensure the integrity and reliability of information, accounts and data, including internal and external reporting and accountability processes.

Standards and Approach

- 9 The IAS's work will be performed with due professional care, in accordance with the requirements of the LSC as detailed in the LSC 's Audit Code of Practice and the standards for the IAS promulgated by HM Treasury. The work shall comply in all material respects with Government Internal Audit Standards (GIAS). The IAS should also have regard to advice provided by professional auditing and accountancy bodies.
- 10 The head of the IAS shall implement measures to monitor the effectiveness of the service and compliance with standards. The head of the IAS should prepare a set of performance measures and criteria for the IAS function, which shall be agreed with the audit committee.
- 11 In achieving its objectives, the IAS shall develop and implement an audit strategy that assesses the FE college's risk management, control and governance processes.

Independence

- 12 The IAS has no executive role, nor does it have any responsibility for the development, implementation or operation of systems. However, it may provide independent and objective advice on risk management, control, governance processes and related matters, subject to resource constraints. For day-to-day administrative purposes only, the head of the IAS reports to a senior officer within the FE college and the reporting arrangements must take account of the nature of audit work undertaken. The head of the IAS has a right of direct access to the chair of the governing body, the chair of the audit committee and the principal.
- 13 The audit committee shall advise the governing body on all matters concerning internal control. Within the FE college, responsibility for the FE college's risk management, control and governance processes rests with the governing body and management, who shall ensure that appropriate and adequate arrangements exist without relying on the FE college's IAS. To preserve the objectivity and impartiality of the IAS's professional judgement, responsibility for implementing audit recommendations rests with FE college management.

Access and Liaison

- 14 The FE college IAS shall have unrestricted access to all documents, records, assets, personnel and premises of the FE college and its companies, and to relevant documents of franchise providers, and be authorized to obtain such information and explanations as they

consider necessary to form its opinion.

- 15 In turn, the IAS agrees to comply with any requests from the financial statements auditors, the LSC, the internal auditors of the Department for Education and Skills (DfES) and the National Audit Office (NAO) for access to any information, files or working papers obtained or prepared during audit work that they need to discharge their responsibilities. The LSC seeks to place reliance upon the work of the FE college's IAS. Liaison is necessary for the LSC to form this opinion and shall not give rise to additional fees.
- 16 The IAS shall liaise with the financial statements auditor, the funding auditor (for those colleges not eligible for plan-led funding), and the LSC's Provider Financial Assurance (PFA) Service Centre to enhance the level of service it provides to the FE college management. The IAS and the audit committee may seek to place reasonable reliance on the work of the funding auditor (where appointed).

Reporting

- 17 The IAS shall prepare, before the beginning of the year, a long-term strategy document supported by an assessment of resource needs and an annual audit plan. These shall be submitted to the governing body for approval following consultation with relevant managers and the principal, and on the recommendation of the audit committee.
- 18 The IAS produces its reports in writing, usually within one month of completion of each audit, giving an opinion on the area reviewed and making recommendations where appropriate. Recommendations should be prioritized. All reports are provided to the principal and should be copied to the audit committee. Heads of department or services shall be required to respond to each audit report, usually within one month of issue. In their response, they should state, for agreed recommendations, their proposed action, the person responsible for implementation and a date by which action will be completed. Material recommendations will usually be followed up some 6 to 12 months later. In addition, the audit committee shall monitor the implementation of audit recommendations by FE college management.
- 19 The head of the IAS submits an annual report to the governing body and principal through the audit committee, based on the FE college's financial year. This gives an opinion on the adequacy and effectiveness of the FE college's risk management, control and governance processes and on the arrangements for securing economy, efficiency and effectiveness.
- 20 The IAS's annual report to the governing body includes:
 - a statement of the overall adequacy and effectiveness of the FE college's risk management, control and governance processes
 - any qualifications to that opinion, together with the reasons for the qualification

- a notice of any issues that the head of the IAS judges relevant to the preparation of the statement of the responsibilities of the members of the governing body, the corporate governance statement (that now incorporates the statement of internal financial control) and the statement on the system of internal financial control, such as an analysis of common or significant weaknesses or details of any major internal audit findings where action appears to be desirable but has not been taken
 - a comparison of the IAS's activity during the year with that planned, placed in the context of the IAS need
 - a summary of the performance of the IAS function against its performance measures and criteria
 - comment on compliance with the GIAS
 - the results of the IAS quality assurance programme.
- 21 The minimum content for an IAS's annual report is set out at Annex E to this supplement.
- 22 The head of the IAS reviews the annual report with the principal and audit committee prior to publication. A copy of the annual report is sent without delay to the local LSC's Regional Audit Manager by the FE college, after it has been received by the governing body on the advice of the audit committee. Copies of other reports and responses to them should not routinely be sent to the LSC's Regional Audit Manager but the LSC's Regional Audit Manager may exceptionally request them.
- 23 The head of the IAS is accountable to the principal and the governing body through the audit committee for the performance of the service. The IAS also reports audit findings to the heads of department or services within the FE college. The head of the IAS shall keep the principal informed of audit results and draw the attention of the audit committee to significant findings and recommendations. This may be done by providing the audit committee with copies of all reports, or by reporting by exception, or by providing a summary of key issues.

Irregularities, Including Fraud and Corruption

- 24 The IAS shall without delay report to the LSC's Chief Executive, and copy to the Executive Director of the local LSC, serious weaknesses, significant fraud, major accounting and other breakdowns, subject to the requirements of the Proceeds of Crime Act 2003.
- 25 The head of the IAS shall be informed when evidence of potential irregularity, including fraud, corruption or any impropriety, is discovered so that he or she can consider the adequacy of the relevant controls, evaluate the implication of the fraud on the risk management, control and governance processes and consider making recommendations as appropriate. The role of the IAS is not to investigate the irregularity unless commissioned to do so.

Ownership of Papers

- 26 The IAS's papers are the property of the FE college. In the event of a change of the IAS provider, the outgoing IAS provider may, with the agreement of the FE college, surrender all audit working papers which demonstrate compliance with the GIAS. Arrangements should be made for the outgoing IAS provider to meet the incoming IAS provider where appropriate.
- 27 [If the governing body agree that the working papers remain the property of the IAS provider, the wording of Appendix C of the Institute of Chartered Accountants in England and Wales Technical Release 2/98 *Access to the Working Papers of Internal and External Auditors of FE Colleges* should be followed. This is available at www.icaew.co.uk/viewer/index.cfm?AUB=TB2I_2122.]

Electronic Communication

- 28 During the engagement, the IAS and the FE college may from time to time communicate electronically with each other. However, the electronic transmission of information cannot be guaranteed to be secure or free of viruses or error and such information could arrive late or incomplete, be intercepted, corrupted, lost, destroyed, or otherwise be adversely affected or unsafe to use. No systems or procedures can guarantee that transmissions will be unaffected by such hazards.
- 29 The IAS and the FE college confirm that each accepts the risks of electronic communications between each other. Each agrees to use commercially reasonable procedures to check for the most commonly known viruses before sending information electronically. Each shall be responsible for protecting its own systems and interests in using electronic communications. The IAS and the FE college shall have no liability to each other on any basis, whether in contract, tort (including negligence) or otherwise, in respect of any error, damage, loss or omission arising from or in connection with the electronic communication of information between each other and the reliance on such information.

Termination of Appointment

- 30 The governing body may, by resolution, remove the FE college's IAS before its term of office expires, notwithstanding any agreement between the IAS and the FE college.
- 31 Where the IAS ceases to hold office for any reason, it shall provide the governing body with either a statement of any circumstances connected with the removal or resignation that it considers should be brought to the governing body's attention, or a statement that there are no such circumstances. The FE college must copy this statement to the LSC's Regional Audit Manager, without delay.

Limitation of Liability

- 32 For internal audit work, FE colleges can negotiate over any proposal by the IAS to restrict or cap their liability. The governing body must specifically consider and approve any request for a liability restriction. This limit must not be under £1 million for smaller FE colleges and more for larger FE colleges.

Annex E: Minimum Content for a Further Education College Internal Audit Annual Report

Introduction

- 3 My internal audit work for the period from 1 August 20[xx] to 31 July 20[xx] was carried out in accordance with the internal audit plan approved by the governing body. The plan was constructed in such a way as to allow me to make a statement of the adequacy and effectiveness of the college's risk management, control and governance processes.

Internal Audit Planned Coverage and Output

- 4 The governing body agreed to an input of [xx] days of internal audit coverage in the year.
- 5 The planned reviews approved by the governing body, the planned number of days and the actual time against plan are shown below. [Insert here a table showing the internal audit review, the type of review (that is, systems audit, compliance audit, controls self-assessment and so on), planned days, actual days and comments. The table should include any additional work carried out.]

Management Action on Recommendations

- 6 Management [have/have not] taken or planned appropriate and timely action to implement our recommendations. [Management have not taken appropriate and timely action on the following significant recommendations.]

Operational Assurance

- 7 The IAS reviewed and evaluated the college's processes in a number of business areas: [Insert a list of the business areas audited in 20xx/xx and the process reviewed.]
- 8 From these examinations the IAS concluded that the policies, procedures and operations in place to:
 - establish and monitor the achievement of the college objectives are [good/adequate/weak]
 - identify, assess and manage the risks to achieving the college's objectives are [good/adequate/weak]

- advise on, formulate, and evaluate policy, within the responsibilities of the principal as accounting officer, are [good/adequate/weak]
- ensure economical and efficient use of resources are [good/adequate/weak]
- ensure compliance with the college's policies, procedures, laws and regulations are [good/adequate/weak]
- safeguard the college's assets and interest from losses of all kinds, including those from fraud, irregularity and corruption, are [good/adequate/weak]
- ensure the integrity and reliability of information, accounts and data, including internal and external reporting and accountability processes, are [good/adequate/weak.]

Overall Assurance

9 As the head of internal audit of [name of college], I am required to provide the governing body and the principal with an opinion on the adequacy and effectiveness of the college's risk management, control and governance processes. In giving my opinion it should be noted that assurance can never be absolute. The most that the IAS can provide to the governing body is reasonable assurance that there are no major weaknesses in the college's risk management, control and governance processes. In assessing the level of assurance to be given, I have taken into account:

- all audits undertaken during [insert 20xx, the year reported upon]
- any follow-up action taken in respect of audits from previous periods
- any significant recommendations not accepted by management and the consequent risks
- the effects of any significant changes in the college's objectives or systems
- matters arising from previous reports to the governing body
- any limitations which may have been placed on the scope of internal audit
- the extent to which resource constraints may impinge on the head of the IAS's ability to meet the full audit needs of the college
- what proportion of the college's audit need has been covered to date
- the outcomes of the IAS's quality assurance processes
- the results reported in the funding auditor's management letters (where appropriate).

Opinion

- 10 I [am/am not] satisfied that sufficient internal audit work has been undertaken to allow me to draw a reasonable conclusion as to the adequacy and effectiveness of the college's risk management, control and governance processes. In my opinion [name of college] [has/does not have] adequate and effective management, control and governance processes to manage its achievement of the college's objectives.

Possible Qualifications

- 11 [These qualifications must only be used with an adverse opinion.]Where significant deficiencies in [risk management/control/governance] processes have been identified by either management or the IAS, I am satisfied that they have been resolved in an appropriate manner.

[or]

Where significant deficiencies in [risk management/control/governance] processes have been identified by either management or the IAS, I am satisfied that the actions the college's management plan to take will, if implemented satisfactorily, resolve the deficiencies in an appropriate manner.

[or]

This opinion is based upon my conclusion that significant deficiencies in [risk management/control/governance] processes have not been adequately resolved.

[or]

Restrictions to the audit programme prevent me from providing an opinion on the adequacy and effectiveness of [risk management/control/governance] processes.

[or]

I have not completed sufficient work at the college to date to enable me to conclude whether [name of college] has adequate and effective [risk management/control/governance] processes.

Performance of the Internal Audit Service

- 12 Annual performance indicators set by the audit committee at the [summer/autumn] meeting are listed below.
- 13 [Insert a list of annual performance indicators compared with the actual performance of the IAS with explanatory comments as appropriate.]
- 14 The results of the internal audit quality assurance programme are set out below.
- 15 [Insert a brief description of the quality assurance programme and the main results.]
- 16 The IAS [has/has not] complied with the Government Internal Audit Standards (GIAS) and the requirements of the LSC's Audit Code of

Practice. [The wording of the report need not be restricted to that shown. The head of the IAS may wish to expand the text, for example where there are areas of deficiency.]

Annex F: Funding Audit Arrangements for Colleges not Eligible for Plan-led Funding

Introduction

- 17 From 2004/05 onwards, the majority of FE colleges are eligible for plan-led funding. For those colleges which are not eligible for plan-led funding, there will continue to be a year-end reconciliation process and, where appropriate, clawback of unearned funds in relation to 2004/05 and future years when they remain ineligible for plan-led funding. This reconciliation will be calculated on the LSC's detailed funding methodology, as for 2003/04.

Appointment

- 18 For the years 2000/01 to 2003/04, the LSC has contracted with seven firms of auditors to undertake the audit of FE colleges' funding claims. For guidance relating to the funding audit work being carried out in respect of 2003/04, readers should refer to the Interim Audit Code of Practice.
- 19 As noted above, those colleges that are not eligible for plan-led funding for 2004/05 and subsequent years will still be subject to a funding audit in addition to the regularity audit. Funding auditors will be appointed by the LSC in the same way as for previous years. The funding audit approach under plan-led funding has not yet been finalized, but it is expected to mirror the approach used for 2003/04.
- 20 The LSC reserves the right to review the appointment of the funding auditors annually, and reappointment will be subject to satisfactory performance. The duties of the funding auditor are clearly presented in a standard letter of engagement between the auditor and the LSC. The contracts are managed by the PFA Service Centre.
- 21 The planned cost of the funding audit is met by the LSC. Where the funding auditors encounter significant unforeseen problems attributable to FE colleges, the cost of significant over-runs will be borne by those FE colleges as per the arrangements for 2003/04. Before funding auditors incur such additional time, they must agree the nature and extent of any additional work with the local LSC and the FE college.
- 22 Under their contract with the LSC, funding auditors are permitted to perform only certain additional services at FE colleges that they audit. These will be set out when arrangements are finalized. Any doubt about the permissibility of services that are additional to the funding audit must be referred to one of the LSC's Regional Audit Managers, who will advise on what is acceptable.

Monitoring performance of funding auditors

- 23 The audit committee may wish to identify and approve annually appropriate performance indicators for the funding auditor, where appointed. The LSC is ultimately responsible for monitoring the performance of funding auditors. FE college audit committees should oversee the audit of the FE college's funding claims and the submission of returns to the LSC. The LSC's Director of External Assurance will seek feedback from FE colleges and their audit committees on the performance of the funding auditors through client satisfaction surveys, which include standard questions set by the LSC.

Liaison between internal auditors and funding auditors

- 24 In colleges where a funding auditor is appointed, the LSC wishes to minimize duplication between the work of the FE college IAS and the LSC-appointed funding auditor. The funding auditor conducts extensive work on the learner number systems in undertaking the funding audit. The funding auditor will report the findings of his or her work in annual opinions and management letters to the FE college. The funding auditor's work is based upon standard LSC audit programmes at every FE college, which are available on the LSC website (www.lsc.gov.uk).

Quality assurance

- 25 The LSC will put in place quality assurance arrangements whereby the work undertaken by the LSC-appointed funding auditors is reviewed and assessed. The results of these reviews along with the use of standard audit programmes and operating guidance ensure that the funding auditor's work is carried out to an appropriate standard. The LSC will offer assurance on the FE college's learner number systems based on the results of these reviews. The FE college's IAS must review the findings set out in the funding auditor's interim opinion and management letter when considering the annual statement on the FE college's risk management, control and governance processes. The FE college's IAS and the audit committee must decide whether to place reasonable reliance on the work of the funding auditor or to conduct work themselves to derive assurance on the FE college's learner number system.

Audit Approach

- 26 The funding auditors will agree a formal, deliverable timetable with FE college management to ensure that the audit work is carried out to enable the meeting of deadlines for the submission of funding claims and related records and data returns. This timetable will need to take account of meetings of the governing body to approve the financial statements and also meetings of the audit committee to review the management letter and the finance or audit committee to consider the financial statements before recommending them to the governing body. Funding auditors will inform local LSCs of key audit milestones.

Reporting

- 27 In previous years, the funding auditor has formed interim and final opinions on the FE college's funding claims and related records and data returns. These opinions were copied to local LSCs and FE colleges.
- 28 From 2004/05 the timing and sequence of events may change. This is due to the use of the previous year's historical data for achievements, rather than waiting until December or January for the actual data. This may remove the requirement for an interim funding claim. Arrangements will be set out in a funding claims circular, or equivalent, for 2004/05.
- 29 At colleges not eligible for plan-led funding, the financial statements auditor must not sign off his or her audit report until a cash recovery and/or responsive growth statement or equivalent has been provided by the LSC confirming the FE college's funding and an assurance letter has been received from the Executive Director of the local LSC. Audit work on the financial statements must not be delayed until receipt of the cash recovery and/or responsive growth statement. To avoid delay, financial statements auditors must undertake their work on the basis of interim figures provided by the FE college.
- 30 The LSC will produce a model management letter in guidance that is issued from time to time. The format of the management letter will be standardized to aid consistency in reporting across the sector. The format of the management letter will be posted to the LSC website (www.lsc.gov.uk) in due course.
- 31 The LSC's funding auditors will promptly send a copy of their finalized management letters, including those arising from any interim audit, audit of the final funding claim and other reports of audit findings, to the FE college and to the LSC's Regional Audit Manager. The list of Regional Audit Managers and their contact details are published on the LSC website (www.lsc.gov.uk/National/Documents/SubjectListing/FundingLearning/ProviderFinance/ProviderFinancialAssurance/Contactdetails.htm).
- 32 Where the provider has subcontracted, franchised or partnership learning provision, the funding auditor will perform spot-check visits, in accordance with a standard matrix set out by the LSC. This will result in a separate letter that will be prepared in accordance with a model format provided by the LSC for funding auditors to use. The format of this management letter will be posted on the LSC website in due course. As with the management letter, issues arising from the spot-check visits must, in the first instance, be discussed with the FE college.
- 33 Although there is no contractual relationship between the FE college and the funding auditor, the LSC will require its contractors to liaise with and report to FE college audit committees. Under the terms of the funding audit contract, the funding auditor will attend FE college audit committee meetings to present the management letter prior to its submission to the LSC.

Annex G: Accountability of Local Authorities and the Role of the Audit Commission

Overarching Accountability Requirements on Local Authorities

- 34 As a body responsible for the conduct of public business and for spending public money, local authorities are accountable for ensuring both that public business is conducted within the law and to proper standards, and that public money is safeguarded, properly accounted for and used economically, efficiently and effectively. In discharging this duty, authorities and their management (both members and officers) are responsible for putting in place:
- proper arrangements for the governance of their affairs and the stewardship of the resources at their disposal
 - adequate and effective systems of internal control, including financial monitoring and reporting arrangements.
- 35 Under the Audit Commission's (the Commission's) Code of Audit Practice, auditors appointed by the Commission give an independent opinion on local authorities' financial statements and may review, and report on, aspects of the arrangements put in place to ensure the proper conduct of their financial affairs and to manage their performance and use of resources. Under section 28 of the Audit Commission Act 1998, the Commission will also arrange to certify claims or returns in respect of grants or subsidies paid to the local authority.
- 36 Local authorities must satisfy themselves that they will be able to comply with the terms and conditions of the LSC's funding before accepting it. They must establish effective administrative and financial systems for each of the LSC's funding streams, and these systems must include adequate and effective internal controls and proper arrangements to prevent and detect fraud. The accounting records for the LSC's funds must be sufficient to show all of the authority's transactions, and be kept up to date and maintained in accordance with proper practices.
- 37 Local authorities are responsible for the proper, accurate and timely preparation of the claims and returns required by the LSC. Claims and returns must be completed in accordance with the terms and conditions of the LSC's schemes. Their preparation should be adequately supervised and reviewed before the certificate required from the local authority's Chief Finance Officer is given, so that the Chief Finance Officer may be satisfied with the entries made and that the assurance given by his or her certificate is well founded. Claims and returns must

be supported by adequate working papers (including, where applicable, non-financial records) that:

- satisfy the statutory requirement on the Chief Finance Officer (under Regulation 5, Accounts and Audit Regulations 2003, SI 2003/533) to maintain adequate records in relation to claims
- document the basis of the claim or return and the derivation of the information it contains
- are kept in a form that will help the auditor and reduce certification time (and, therefore, the cost to the authority).

Certification by Auditors Appointed by the Audit Commission

- 38 Currently the LSC seeks assurance from auditors appointed by the Audit Commission on its adult and community learning (ACL) and FE funding. The Audit Commission has a statutory responsibility to make arrangements for the certification of grant claims and returns, including those which the LSC requires for its funding. Local authorities are responsible for ensuring that only the auditor appointed to them by the Audit Commission certifies claims and returns for the LSC's funding.
- 39 Certification work is not covered by the Commission's Code of Audit Practice as the Commission, rather than its appointed auditors, has responsibility for making certification arrangements. Appointed auditors are required to comply with:
- the Commission's general certification instruction (CI A01) for claims and returns
 - the specific instructions issued by the Commission for the LSC's funding streams, which are developed in consultation with the LSC.
- 40 Where appropriate for certification purposes, auditors should consider whether reliance can be placed on their other work (on systems, final accounts, or fraud and corruption) carried out during their audit of the authority's financial statements.
- 41 Occasions arise when claims or returns include entries for which another body holds the only supporting information. This is an increasingly common situation with contracted-out tuition and other operations and where partnership arrangements mean the authority submits a claim or return based on the transactions of its partners. In these circumstances, in order to complete and certify the claim, the local authority will need assurance that the transactions included in its claims are eligible for grant. The local authority might obtain such assurance, for example, by obtaining independently certified statements for each contracted-out procedure or partner (in sufficient detail to support the eligibility of transactions in its claim) or by undertaking spot-checks for monitoring purposes. Auditors are not normally expected to visit third parties in

cases where insufficient information is held by the authority to support claim form entries and will instead issue a qualification letter to the LSC setting out the facts.

Annex H: Definition of Key Terms

Term	Definition
ACL	See adult and community learning
adult and community learning	The LSC grants funds to local education authorities (LEAs) for the delivery of adult and community learning in accordance with each LEA's adult learning plans. A funding agreement, signed by both parties, records the agreement regarding the amount of funding to be paid in support of the LEA's adult learning plan agreed with the LSC.
DfEE	Department for Education and Employment (now the Department for Education and Skills)
DfES	The Department for Education and Skills (formerly the Department for Education and Employment)
FE college	Further education (FE) college. FE colleges are those incorporated under the Further and Higher Education Act 1992 or funded under the financial memorandum set out in Further Education Funding Council (FEFC) Circular 99/48.
financial memorandum	A memorandum that sets out the terms and conditions of the agreement under which the LSC provides grant-in-aid to FE colleges and dance and drama schools. It provides information on the framework of relationships between FE colleges and the LSC. The financial memorandum is set out in FEFC Circular 99/48.

financial statements auditor	<p>The financial statements audit of a college may be undertaken by:</p> <p>a those accountants who are both registered to audit limited companies in accordance with Part II of the Companies Act 1989 and who are members of one of the following professional accountancy bodies:</p> <ul style="list-style-type: none"> • Institute of Chartered Accountants in England and Wales • Institute of Chartered Accountants of Scotland • Institute of Chartered Accountants in Ireland • Chartered Association of Certified Accountants • Association of Authorised Public Accountants <p>or:</p> <p>b partners in public practice who are members of the Chartered Institute of Public Finance and Accountancy.</p> <p>The Audit Commission may also carry out audits of financial statements for local authorities and the National Health Service (NHS) in England and Wales.</p>
funding agreement	<p>The LSC's funding agreements are its formal terms and conditions for providing funding to FE colleges and other providers. These funding agreements may take the form of a financial memorandum (or part thereof) for grant-in-aid funding, a grant letter or a contract.</p>

funding auditor	The auditor responsible for the audit of LSC funding streams. At FE colleges, the LSC has appointed firms to undertake the audit of college's Individualized Learner Record (ILR) data and final funding claims based upon this data and any claims for LSC funding of the college within the scope of their work.
<i>Government Accounting</i>	HM Treasury guide published by HMSO as <i>Government Accounting: A Guide on Accounting and Financial Procedures for the Use of Government Departments</i>
GIAS	See Government Internal Audit Standards
Government Internal Audit Standards	The LSC specifies in the code that the operation and conduct of the college IAS must comply with the standards of internal audit promulgated by HM Treasury. These standards are known as the Government Internal Audit Standards (GIAS) issued in July 2001. A copy of the GIAS is available online (www.hm-treasury.gov.uk).
IAS	See internal audit
ILR	Individualized Learner Record. The ILR replaced the Individualised Student Record (ISR) for 2002/03 as the records FE colleges and other providers are required to keep as the basis for their funding claims and other statistical and information returns to the LSC and other interested parties.

internal audit	Internal audit is defined in the GIAS as being “an independent and objective appraisal service within an organization”. Each college governing body must appoint an internal audit service (IAS). It must be separate from college management, even if provided in-house, and without any executive, management or operational responsibilities outside internal audit. It is not permissible for FE colleges to appoint as internal auditors the same firm that undertakes the financial statements audit or the contractors appointed by the LSC to undertake the funding audit.
learner number systems	The systems kept by providers to record details of learners. A key element of the learner number systems will be the ILR.
PFA	provider financial assurance
regularity audit	An audit of the regularity and propriety of a college’s spending, performed by the college’s financial statements auditor.
specialist designated institution	A publicly funded FE institution that is incorporated as a limited company
work-based learning	Work-based learning refers to a collective group of learning programmes delivered in a work or work-related setting.

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