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Scottish Higher Education Funding Council

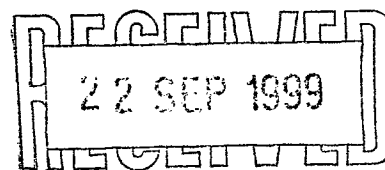
21 September 1999

Circular Letter No. 42/99

**To Principals/Directors of
Higher Education Institutions funded by the
Scottish Higher Education Funding Council**

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Dear Principal/Director



SHEFC CODE OF AUDIT PRACTICE

Background

The original *Code of Audit Practice* was issued by SHEFC in April 1993. In April 1998, a proposed *Revised Code of Audit Practice* was issued to the sector for consultation and comment (SHEFC Consultation Paper 02/98 refers). A large number of detailed responses were received which were subsequently analysed by the Executive and referred back to the Chief Executive's Working Group, which was set up to consider this exercise and which helped to produce the draft. The draft Code was further amended as a result of comments from the Working Group, and was made available to institutions and COSHEP for final consultation in April 1999, with a closing date for comments of 30 June 1999.

SHEFC Audit Committee

Following the final round of consultation, all responses were referred to the Council's Audit Committee. The Committee considered all comments and it was agreed that the Code would be subject to some final amendments. A summary of the key changes has been provided in Annex A to this letter. In addition some minor amendments have been made to the text of the Code.

A copy of the finalised version of the Code, which has been endorsed by the Council's Audit Committee, is attached. I will arrange for further copies of the published version of the Code to be issued to institutions in due course. The Council's Audit Committee has been informed of key issues throughout the development and revision of the Code. The Chairman of the Committee, Mr Jim McColl, would be happy to discuss any concerns that institutions may have as to the implementation of the Code's requirements.

Chairman: Dr. Chris Masters Chief Executive: Professor John Sizer CBE

Observance of the Code

Within the Code, the terms "**must**" and "**will**" (where they are shown in bold type) denote mandatory requirements on institutions. For ease of reference all mandatory requirements are boxed and shaded. The term "should" denotes the Council's view of good practice and the term "may" indicates ideas worthy of consideration.

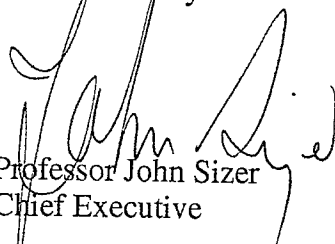
The Code of Audit Practice will become effective on receipt of this letter.

Both SHEFC and the SHEFC Audit Committee would like to thank all members of the Code of Audit Practice Working Group, as well as all those in the sector who responded during the consultation process for their help in the production of the revised Code.

Further information

Any enquiries concerning this Circular Letter should be addressed to Liam McCabe, Director of Financial Appraisal and Monitoring Service (telephone 0131-313-6524/Email: lmccabe@sfc.ac.uk).

Yours sincerely



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Annex A

Final amendments to the *Revised Code of Audit Practice*

Note. These amendments refer to the revised consultation draft of March 1999

Paragraph 2.24 (previously 2.23)

Reference has been made to the corporate governance implications of both the *Statement of Recommended Practice: Accounting in Higher Education Institutions*, published by the British Universities Finance Directors Group and the *Guide for Members of Governing Bodies of Scottish Higher Education Institutions and Good Practice Benchmarks*, issued by SHEFC in 1995.

Paragraphs 3.23, 3.25 & 4.1

The Audit Committee's annual report to the Governing Body and its assessment on the adequacy and effectiveness of the institution's internal control systems has been set in its proper context, and cross references have been made to Paragraphs 4.24 – 4.30 on the Audit Needs and Risk Assessment. It is in terms of the Audit Needs Assessment and with regard to the work of internal and external audit that an institution's Audit Committee is required to make its assessment on the adequacy and effectiveness of the institution's internal control system.

Paragraph 3.26

This paragraph has been expanded to clarify what is meant by the "wider aspects of internal control". It is recognised also, that any system of controls can only provide reasonable and not absolute assurance against material misstatement or loss.

Paragraph 3.27

Provides some clarification as to how the Governing Body and the Audit Committee should agree terms of reference in relation to the wider aspects of internal control.

Paragraph 4.2

Internal audit is defined not only as a service to management at all levels, but as a "key control mechanism". The original reference to the "whole system of internal control" has been removed.

Paragraph 4.4

The "whole system of internal control" reference has been removed. Emphasis has been put on internal audit not being a substitute for good management.

Paragraph 4.24

This paragraph has been expanded to emphasise that the Audit Needs Assessment should consider the "wider aspects of internal control" as described in Paragraph 3.26.

Paragraph 4.83

In defining the role of Internal Audit in cases of impropriety, reference to "providing assurance on the whole system of internal control" has been removed.

Paragraphs 7.1 – 7.3

These paragraphs have been expanded to provide a broader description of the role and scope of the Council's Financial Appraisal and Monitoring Service.

Paragraph 7.4

This paragraph has been amended in order to redefine the responsibilities of FAMS from simply evaluating institution's control arrangements to "monitoring the effectiveness of institution's control arrangements". FAMS will in their cycle of visits review key "financial" as well as management controls.

Annex C

- *Internal Audit*

The second bullet point has been amended to reflect the earlier references to the system of internal control being defined in terms of an Audit Needs Assessment (paragraphs 3.26 and 4.24 – 4.30).

- *Opinion*

The reference to the institutions "whole system of internal control" has been removed.



Scottish Higher Education Funding Council

CODE OF AUDIT PRACTICE

September 1999

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SECTION 1

INTRODUCTION

Requirement for a Code of Audit Practice

1.1 The Financial Memorandum between the Scottish Higher Education Funding Council (the Council) and the Scottish Executive Enterprise and Lifelong Learning Department (SEELLD) requires the Council to issue a Code of Audit Practice (the Code) to the higher education institutions (institutions) that it funds and to monitor institutions' compliance with the Code. In turn, the Council, through its Financial Memorandum with institutions, in the section titled 'Audit', requires institutions to comply with the Code by putting in place audit arrangements including:

- establishment of an Audit Committee;
- formation or appointment of an internal audit service; and
- appointment of external auditors.

Scope of the Code

1.2 The Code sets out the Council's mandatory requirements in relation to institutions' audit arrangements and also provides guidance on good practice for institutions' Audit Committees and external and internal auditors, and sets out the framework within which each should operate. The Code also provides an overview of the roles and responsibilities of the Council's Financial Appraisal and Monitoring Service (FAMS).

Users of the Code

1.3 The Code is for the use of:

- governing bodies, their committees and senior management of institutions, in understanding and complying with the Council's requirements for audit; and
- the internal and external auditors of institutions who are required to comply with the relevant provisions of the Code.

1.4 Designated officers of institutions should make copies of the Code available to each member of their Governing Body and Audit Committee.

Observance of the Code

1.5 Within the Code the terms "**must**" and "**will**" (where they are shown in bold type) denote mandatory requirements on institutions. For ease of reference all mandatory requirements are boxed and shaded. The term "should" denotes the Council's view of good practice and the term "may" indicates ideas worthy of consideration. The Council will assess compliance with the Code's mandatory requirements and the adoption of good practice guidance when reviewing the audit arrangements that an

institution has in place. A number of 'model' documents are included as annexes to the Code. These are for guidance only and, together with the examples of good practice set out, should be used with discretion taking account of local circumstances. A list of the definitions of terms used within the Code is provided in Annex N.

Applicability of the Code

1.6 The Code **must** be read in conjunction with relevant auditing standards, guidelines and other publications issued by the Auditing Practices Board.

1.7 Reference should also be made, where appropriate, to the Government Internal Audit Manual (GIAM) and its companion volume, the Government Information Systems and Audit Manual (GISAM) issued by HM Treasury.

1.8 More detailed advice on any aspect of the Code is available from FAMS. The Council may also supplement the Code with occasional audit practice notes with guidance on good practice in specific areas. Such guidance will generally be developed in consultation with representative bodies in the higher education sector, and may be incorporated into any subsequent revision of the Code.

1.9 The Code provides the framework within which institutions **must** establish an Audit Committee as well as internal and external audit arrangements.

1.10 It may in addition provide a benchmark against which the effectiveness of those arrangements can be assessed by an institution's Governing Body, as well as by the Council in fulfilment of its duty under the Financial Memorandum with SEELLD. The Code is not intended to be a detailed manual. Institutions should consider developing their own manuals which detail local arrangements and procedures appropriate to the institution for audit related matters, having regard to the requirements and good practice guidance contained in the Code.

Revision of the Code

1.11 It may be necessary from time to time for the Code to be revised. The Council intends to keep the operation of the Code under review and will consult interested parties before making any significant amendments. FAMS welcomes comments on the Code and its operation at any time.

SECTION 2

ACCOUNTABILITY OF HIGHER EDUCATION INSTITUTIONS

Background

- 2.1 As recipients of significant amounts of public funding, institutions are subject to specific requirements in relation to the safeguarding and use of these funds. The chain of accountability, as described in the following paragraphs, involves the Scottish Parliament, Scottish Executive Enterprise and Lifelong Learning Department (SEELLD), the Council and institutions.
- 2.2 The Governing Body is the supreme decision-making body of an institution and funds provided by the Council are in effect provided to the Governing Body.
- 2.3 The nature of the Governing Body's role in terms of it being publicly accountable for its stewardship of public funds, demands the highest standards of corporate governance and that in the exercise of its functions, it conducts its public business properly at all times. The existence of a rigorous framework of audit and internal controls can assist governors in this process.

Parliament and the National Audit Office (and Scottish Parliament equivalents)

- 2.4 Financial relations between the Crown and Parliament are governed by the principle that the Crown, acting on advice from Ministers, requests funds. Parliament grants these funds and relies on the National Audit Office to check that they have been spent as Parliament intended, properly accounted for, and that value for money has been achieved in the use of those funds.
- 2.5 The head of the National Audit Office, the Comptroller and Auditor General, is an officer of the House of Commons. He is responsible under Schedule 7, paragraph 14 (3) of the Further and Higher Education (Scotland) Act 1992 (the Act) for the audit of the Council's accounts. In addition, section 53 of the Act confers on the Comptroller and Auditor General the right to inspect the accounts of any institution in receipt of grant and to carry out value for money investigations in the Council or in institutions.
- 2.6 For their financial audit of the Council, the Comptroller and Auditor General and the National Audit Office are concerned to be satisfied that funds provided to the Council are properly controlled and accounted for, and applied for the purposes for which they were provided. For this work the NAO will work largely through the Council's records and procedures.
- 2.7 The Scottish Parliament came into being on 1 July 1999. This will have an impact on the oversight of funds currently undertaken by NAO, as described in paragraphs 2.4 - 2.6. A new body, Audit Scotland, headed by the Auditor General for Scotland (AGS), will assume responsibility for the work currently undertaken by NAO in relation to funds provided by the Council to Scottish Higher Education Institutions. The precise nature of the relationship between the Council and Audit Scotland has yet to be determined.

- 2.8 In addition to its financial audit work, in recent years the NAO has published a number of reports dealing with aspects of the higher education sector in England, Wales and Scotland. These have included broadly based value for money reviews of the use of resources in the sector. (Annex I provides details) and reports on financial management and governance in individual institutions. (Annex L provides details).

Scottish Executive Enterprise and Lifelong Learning Department (SEELLD)

- 2.9 The Accounting Officer (AO) of SEELLD is accountable to Parliament for the funds which are issued to the Council. Among other things, the AO (SEELLD) is responsible for ensuring that the financial management and other controls applied by SEELLD and by the Council are sufficient to safeguard public funds and satisfy the requirements of propriety. Audit is a key element of these controls and hence the Council is required by SEELLD to have an audit service and to operate appropriate and effective monitoring systems. SEELLD is required to satisfy itself that the Council has in place effective internal audit arrangements and, in turn, the Scottish Office Audit Unit (SOAU) will wish to ensure that SEELLD has adequate controls in place to review the Council's arrangements. The SOAU will on occasion visit the Council. This may include observation of the work of FAMS in institutions, but it will not involve the audit of institutions directly by SOAU.

The Scottish Higher Education Funding Council

- 2.10 The Council's Chief Executive is Accounting Officer for the funds the Council receives from SEELLD and is accountable to the Scottish Parliament for those funds. Among other things, the AO (SHEFC) **must** be satisfied that institutions are making proper arrangements to ensure that public funds are being used for the purposes for which they were given and comply with the conditions attached to them and are adequately safeguarded. In order to help obtain this assurance, FAMS will periodically monitor compliance with the Code and assess the adequacy and reliance of the internal management controls of institutions. The most efficient way of FAMS performing this task is to seek to rely on the work of institutions' internal and external auditors, where appropriate, and so avoid duplicating audit investigations.
- 2.11 During its monitoring visits to institutions, FAMS will consider the extent to which institutions have observed the Code. It is intended that this should help to provide an overview of the existence, adequacy and effectiveness of an institution's financial control and audit arrangements. FAMS would not expect to carry out detailed audit work at institutions unless, in the light of this evaluation or other appropriate information, there was evidence or indication that sufficient reliance could not be placed on an institution's own internal control arrangements.

Governing Bodies of Institutions

Role and Responsibility of the Governing Body

- 2.12 The Governing Body is responsible for the institution's strategic direction, reputation, financial health, the well-being of staff and students, and in association with the Senate or equivalent body, for establishing and maintaining high standards of academic conduct and probity.
- 2.13 These responsibilities (which are consistent with the *Guide for Members of Governing Bodies of Scottish Higher Education Institutions*, and *Good Practice Benchmarks*, issued by the Council in February 1999, makes clear that the Governing Body is ultimately responsible for the conduct of the institution's affairs. This scope of responsibility was also recognised in *Higher Education in the Learning Society*, published in June 1997, the Report of the National Committee of Inquiry into Higher Education.
- 2.14 In the course of discharging its responsibilities, a Governing Body has a particular duty to observe the highest standards of corporate governance.
- 2.15 In formal terms the Governing Body of an institution is responsible for ensuring that funds from the Council are used only in accordance with the Act, the institution's Financial Memorandum with the Council, and any other conditions which the Council may from time to time prescribe.
- 2.16 At the detailed level the Governing Body is responsible for ensuring the establishment and maintenance of effective arrangements to:
- ensure that the institution has in place effective internal control systems to safeguard the assets of the institution and to prevent and detect fraud;
 - ensure that the financial, planning and other management controls, including controls against fraud and theft, applied by the institution are appropriate and sufficient to safeguard public funds and funds from other sources, and to ensure that the funds are only used in accordance with the conditions under which they were made available;
 - secure the economical, efficient and effective management of the institution's resources including capital assets, equipment and personnel so that the benefits that should be derived from the application of public funds by the Council are not put at risk; and
 - ensure sound corporate governance and the proper conduct of the institution's operations.
- 2.17 To assist the Governing Body with meeting these responsibilities, the Financial Memorandum with the Council requires that the Governing Body **must** establish an Audit Committee (see Section 3).

- 2.18 Under the terms of the Financial Memorandum (paragraph 13), the Governing Body is required to designate a Principal Officer, referred to as the Designated Officer. The Designated Officer is responsible to the Governing Body for ensuring the proper and effective operation of controls and may be required to appear before the Audit Committee of the Scottish Parliament, alongside the Accounting Officer of the Council, and the Accounting Officer, SEELLD, on matters relating to the funds paid by the Council to the institution or other matters which the Audit committee of the Scottish Parliament may examine.
- 2.19 An institution is required to keep proper accounting records and to provide, in respect of each financial accounting period, financial statements prepared in accordance with the *Statement of Recommended Practice (SORP): Accounting in Higher Education Institutions* published by the CVCP, COSHEP and SCOP and, where appropriate, the Companies Acts. The Governing Body is required to appoint an external auditor to audit the financial statements in accordance with relevant Auditing Standards and Guidelines and this Code of Practice.

2.20 The Governing Body **must** inform the Councils without delay of the removal or resignation of an external or internal auditor during their term of contract.

- 2.21 Internal audit operates as a service to management at all levels by providing an objective assessment of whether management's systems and controls are working effectively. The Council considers that internal audit is a key element of an institution's overall system of internal control.

2.22 In accordance with the Financial Memorandum with the Council, the Governing Body **must** secure an effective internal audit service.

- 2.23 Statement of Auditing Standard 600: Auditors' Reports on Financial Statements requires auditors' reports on financial statements to include a separate section, appropriately headed, dealing with the respective responsibilities of directors or equivalent persons.
- 2.24 The guidance notes on the SORP, issued by the British Universities Finance Directors Group, covering the responsibilities of the governing body in relation to financial management and the financial aspects of corporate governance are included as Annex A to the Code. Institutions should follow the most up to date version of this guidance, which was first issued in 1995 and which will be updated from time to time. In addition, in Circular 05/99 concerning the publication of its *Guide for Members of Governing Bodies of Scottish Higher Education Institutions and Good Practice Benchmarks*, the Council has requested that institutions compare their existing practices with those recommended in the Guide, and to publish the outcome in their annual reports.

Improprieties, including Fraud and Corruption

- 2.25 The Governing Body has overall responsibility for ensuring that there are adequate arrangements in place for the prevention, detection and investigation of improprieties, including fraud and corruption.

2.26 The Designated Officer of an institution **must** report to the Chairman of the Governing Body, the Chairman of the Audit Committee and the Chief Executive of the Council, without delay, serious weaknesses, significant fraud or irregularity or any major accounting or other control breakdown which comes to light, other than through the external auditor's work (see paragraph 5.22 which requires the external auditor to report such matters directly to those individuals).

2.27 Propriety is concerned with Parliament's intention as to the way in which public business should be conducted. It embraces standards of conduct, behaviour and corporate governance and includes matters such as the avoidance of personal profit for public business, even-handedness in the appointment of staff, open competition in the letting of contracts and the avoidance of waste and extravagance. Impropriety may be defined as any behaviour, activity or conduct which falls outside accepted standards in such areas.

2.28 A serious weakness is one that may result in a significant fraud or loss. Information on recent cases of fraud etc, suitably anonymised, may be disseminated throughout the sector by FAMS, thereby enabling a Governing Body to take whatever action it considers necessary to protect its institution's interests in similar areas.

2.29 In this Code a serious weakness includes one that has or may result in an attempted, suspected or actual significant fraud or irregularity. Significant fraud is usually where one or more of the following applies:

- a. The sums of money involved are, or potentially are, in excess of £10,000.
- b. The particulars of the fraud are novel, unusual or complex.
- c. There is likely to be public interest because of the nature of the fraud or the people involved.

2.30 There may be circumstances that do not fit this definition. In these cases or any others, institutions can seek advice or clarification from the Council's Director of FAMS. In view of the public interest, institutions should normally notify the police of all suspected or actual fraud. Where the police are not notified, management should advise the Audit Committee of the reason.

SECTION 3

AUDIT COMMITTEES IN HIGHER EDUCATION INSTITUTIONS

Constitution of Audit Committee

- 3.1 As stated in Section 2, the Governing Body of an institution **must** establish proper arrangements to ensure the effective discharge of its responsibilities in respect of:
- proper financial management;
 - the effectiveness of the internal control and management systems;
 - safeguarding the assets of the institution and public funds;
 - the economy, efficiency and effectiveness of the institution's activities; and
 - corporate governance and conduct of the institution's operations.

- 3.2 As an essential part of the arrangements for meeting these responsibilities, the Governing Body **must** establish an Audit Committee. (This is required by the Financial Memorandum with the Council).

- 3.3 An effective Audit Committee with sufficient authority, expertise and independence can provide the Governing Body with impartial and authoritative advice on matters relating to audit and internal control. Objectivity and independence are essential for the successful operation of the Audit Committee. The Audit Committee should be independent of the executive management of the institution and, unless there are good reasons of impracticality, should be independent of the Finance Committee.

- 3.4 The Audit Committee **must** be formally constituted by the Governing Body to ensure that its relationship with the Governing Body, to whom it is accountable, is clear. The Audit Committee should report, or have the right to report, its advice directly to the Governing Body. The Audit Committee **must** be given sufficient resources and authority in its relationships with the Governing Body, management and other appropriate parties, including external and internal auditors, to fulfil its responsibilities.

- 3.5 The Audit Committee **must** be given written terms of reference, approved by the Governing Body, which deal adequately with its membership, authority, goals and duties. The terms of reference and membership of the Committee should be disclosed in the institution's annual report and accounts. The terms of reference should be periodically reviewed to ensure that they remain relevant and appropriate.

- 3.6 The Governing Body **must** ensure that an appropriate officer is assigned responsibility to establish and maintain effective mechanisms to inform the Audit Committee members of relevant reports and other publications which impact on the Committee's work. The officer responsible could, for example, be the Secretary to the Audit Committee.

- 3.7 FAMS will issue institutions with copies of relevant reports published in the future by bodies such as the Funding Councils and NAO. Annexes I H and L contain the titles of some relevant reports published in recent years by the NAO, UK HE Funding Councils and other bodies.

Membership of the Audit Committee

3.8 The Audit Committee **must** comprise of at least three members.

3.9 Non-executive members of the Governing Body should usually be in the majority. At least one member should have a background in finance, accounting or auditing but membership should not be drawn exclusively from people with such a background.

3.10 In order not to jeopardise, or to be perceived to jeopardise, the Audit Committee's objectivity or independence, a number of restrictions on membership is necessary or advisable:

- The Principal / Director of the institution **must not** be a member;
- Similarly, other members of the institution's senior management such as Vice-Principals, Assistant Principals, Secretary, Executive Directors and their equivalents **must not** be members.
- No connected party such as an employee or partner of the institution's solicitors, bankers, auditors, insurers or other professional advisers should be a member.
- Members of the Finance Committee of the institution, or anyone with executive authority within the institution, should not normally be members. Where this is unavoidable for mandatory or practical reasons, such members **must** be in the minority and **must not** hold the Chair of the Audit Committee.
- The Chairman of the Governing Body should not normally be a member of the Audit Committee.

3.11 The Committee should, if it considers it necessary or desirable, be able to co-opt non-executive members who are not members of the Governing Body and who have particular relevant experience or expertise. Co-opted members should not normally be appointed as Chairman of the Audit Committee, as in normal circumstances the Chairman would have the right to attend all meetings of the Governing Body. In the exceptional case of such an appointment, arrangements should be made to ensure that the Chairman has full access to the Governing Body for reporting purposes. Subject to this, the status on the Audit Committee of co-opted members should be equivalent to full Governing Body members.

3.12 Where cross-membership of the institution's Audit Committee and Finance Committee does not exist, it may be considered good practice to have the Chairman of the Audit Committee attend Finance Committee meetings to ensure that matters concerning the Audit Committee are given appropriate weight by the Finance Committee and to inform future meetings of the Audit Committee. Institutions may wish to consider whether the Chairman of the Finance Committee should attend meetings of the Audit Committee.

3.13 Institutions should have in place a procedure whereby a decision based on objective criteria would be taken regarding an individual's membership where that membership may jeopardise, or be perceived to jeopardise, the Audit Committee's objectivity or independence.

- 3.14 There should be in place a mechanism for members to declare an interest if invited to consider any business which may conflict with their other duties and responsibilities; they may then be excluded from consideration of such items of business, if deemed appropriate. Further, a Register of Interests of all of the Committee's members is advisable.
- 3.15 The Audit Committee should ensure that procedures are in place for members to receive any briefing or training required regarding finance, audit or other matters in light of the goals and duties of the Committee. Audit Committees may wish to issue briefing packs to new members and existing members should be encouraged to maintain a basic understanding of the institution's financial reporting processes. Committee members should normally be provided with a copy of the guidance on audit committees issued by CIPFA and the ICAEW, as detailed in paragraph 3.29.

Proceedings of the Audit Committee

- 3.16 The Committee should be given maximum discretion by the Governing Body to determine its proceedings within its terms of reference. However, the Committee should meet at least three times per year and the timing and content of the meetings should follow, as far as possible, the planning and reporting cycles of internal and external audit. The Finance Officer, or his or her representative, and the Head of the Internal Audit Service should normally be invited to attend Audit Committee meetings. The Principal and other staff may also be invited to attend as appropriate given the areas of responsibility under examination.

- 3.17 The external auditor **must** attend, as a minimum, any meetings of the Audit Committee where relevant matters are being considered, such as planned audit coverage, the audit report on the financial statements and the audit management letter. It is the responsibility of the Secretary to the Audit Committee to notify the external auditor of such meetings. The Head of the Internal Audit Service (IAS) and the external auditor **must** have a right of access at any time to the Chairman of the Audit Committee and also a right to ask the Chairman to convene a meeting if either one deems it necessary. Further, this **must** extend to the right to ask for such a meeting to be in closed session.

- 3.18 The Committee should have explicit authority to investigate any matters within its terms of reference, adequate resources to do so, and full access to information and personnel.
- 3.19 The Committee should have the right, whenever it is satisfied it is appropriate, to go into confidential sessions and exclude any, or all, non-members or observers.
- 3.20 The clerk to the Governing Body or some other equivalent independent person should normally be the Secretary to the Audit Committee. Where the clerk has significant financial or other responsibilities at senior management level within the institution, the Governing Body should consider whether the role of Secretary to the Committee should be transferred to another individual to maintain independence, or whether sufficient safeguards are built into the existing arrangements.

Reporting by the Audit Committee

3.21 The Chairman of the Audit Committee should submit either the minutes of, or a written summary report of, significant matters arising from each Audit Committee meeting to the Governing Body.

3.22 The Audit Committee **must** produce an annual report to the Governing Body.

3.23 The report should include the Audit Committee's assessment on the adequacy and effectiveness of the institution's internal control systems (defined in terms of an Audit Needs Assessment outlined in Paragraphs 4.24 – 4.30). This assessment should be based on the results of the work of the IAS as reported in the IAS's annual report (see paragraph 4.53), and the external auditor's opinion on the financial statements as well as the management letter (in draft if necessary). The report should also incorporate any significant matters arising from the work of internal audit, external audit, the value for money programme and any FAMS or other relevant review, as well as key administrative information pertaining to the Committee. The report should normally be submitted to the Governing Body before the Governing Body's statement of responsibilities is signed.

3.24 A copy of the Committee's annual report **must** be submitted to the Chief Executive/Accounting Officer within one month of being presented to the Governing Body. Where an annual report has not been submitted to the Governing Body by 31 December, following the end of the institution's financial year to which it relates, a draft copy of the report **must** be submitted to FAMS by that date.

Duties of the Audit Committee

3.25 The precise duties of the Audit Committee should be determined by the Governing Body in the light of the institution's needs. These duties should normally include reviewing and advising the governing body in relation to:

- The institution's systems of internal control (defined in terms of an Audit Needs Assessment outlined in Paragraphs 4.24 – 4.30)
- Internal audit
- External audit (including consideration of annual financial statements)
- Value for money audit
- Such advice to the Governing Body as the Committee considers appropriate.

Guidance on these duties is considered in more detail in Annex B.

3.26 The Audit Committee will be concerned with internal financial controls such as the maintenance of proper accounting records, reliability of financial information, the safeguarding of assets and the mechanisms in place to ensure the proper use of public funds. In addition the Audit Committee will be concerned with the wider aspects of internal control. The wider aspects of internal control should cover the identification of key business risks, evaluating their financial implications and establishing policies for managing those risks. However in doing this it is recognised that any such system

of controls can only provide reasonable and not absolute assurance against material misstatement or loss. The wider aspects of internal control should also extend to good corporate governance as this forms an integral part of the system of internal control.

- 3.27 In defining formally the Audit Committee's terms of reference, the Governing Body should consider, with the Committee, the extent to which the Committee should have a role in relation to these wider aspects of internal control. The Governing Body may wish to consider, for example, utilising the Committee's appreciation of business risk at a strategic level to inform the Governing Body's consideration of the wider aspects of internal control.

Effectiveness of the Audit Committee

- 3.28 The National Committee of Inquiry into Higher Education Report recommends (recommendation 57) that each Governing Body should systematically review, at least once every five years, its own effectiveness by utilising appropriate external assistance and benchmarks. Such review would necessarily include review of committees of the Governing Body, including its Audit Committee. The Government agrees with this recommendation and considers that the outcomes of the review should be published in the institution's annual report as a condition of public funding.
- 3.29 Assessment of the effectiveness of the Audit Committee would ideally comprise self-assessment by the Committee and feedback from the institution's management, as well as from internal and external audit, in addition to a review by the Governing Body. External assistance could be contracted to perform the assessment so long as the assessor is not the provider of the internal or external audit service.

Further Information

- 3.30 Reference should also be made to the CIPFA *'Handbook for Audit Committee Members in Further and Higher Education'*, published in 1996, and the ICAEW Audit Faculty guidance *'Audit Committees: A Framework for Assessment'* issued in 1997. These publications provide additional information on the foundation and role of audit committees.

SECTION 4

INTERNAL AUDIT

Requirement for an Internal Audit Service

- 4.1 In accordance with the institution's Financial Memorandum with the Council, the Governing Body is required to secure the provision of an effective internal audit service (IAS). The prime responsibility of the IAS is to provide the Governing Body, the Designated Officer and other senior management of the institution, with an objective assessment of the adequacy and effectiveness of management's internal control systems (defined in terms of an Audit Needs Assessment outlined in Paragraphs 4.24 – 4.30).
- 4.2 Internal audit is an independent appraisal function established by management to review the institution's internal control systems. The IAS will objectively examine, evaluate and report on the adequacy of internal control, thus contributing to the economic, efficient and effective use of resources and to the reduction of the potential risks faced by the institution. Internal audit is a key control mechanism, as well as a service to management at all levels, with a scope covering all the activities of the institution including those not funded by the Council. Coverage includes all the institutions' operations, resources, staff, services and responsibilities to other bodies although does not extend to the academic process.
- 4.3 To be effective, the IAS **must** be distinct from and independent of the institution's external audit provision and should have no executive responsibilities.
- 4.4 Internal audit is not a substitute for good management, the operational responsibility for which rests fully with senior management.
- 4.5 The IAS can deliver significant benefits to an institution through its primary focus on the internal control systems, often resulting in improved performance and better management of risk. The IAS can also add value to the institution by its involvement in value for money studies and special investigations. Further, the IAS may be requested by management to provide advice on the appropriate standards of controls to be implemented in relation to new systems, or review procedures before they are implemented to minimise the risk of control weaknesses being introduced, provided that its independence and objectivity in performing future internal audit work will not be compromised.
- 4.6 The IAS **must not** be directly involved in designing, installing and operating systems or the drafting of procedures for systems. Performing such duties **will** compromise audit objectivity.

Terms of Reference

4.7 The IAS **must** have formal terms of reference agreed by the Governing Body, on the recommendation of the Audit Committee, which should have regard to the provisions of this Code in drawing up and approving the terms of reference. The terms of reference should form part of the letter of engagement for the provision of internal audit services by external providers, or the job description of the Head of IAS where the service is provided in-house.

4.8 The scope and detail of the terms of reference **must** be such that they enable the Head of the IAS to provide the Governing Body with an objective assessment of the adequacy, reliability and effectiveness of the institution's internal control system.

4.9 The Head of IAS **must** advise the Governing Body of the risks to which they, and the institution, may be exposed if the scope of the audit coverage is limited in any way. Where the Head of IAS believes that any limitations are unacceptable, his or her views and opinion on the associated risks **must** be formally reported to the Chairman of the Governing Body, the Chairman of the Audit Committee and the Designated Officer.

4.10 Model terms of reference are set out in Annex D, However, local circumstances may vary and the model terms may have to be modified to suit individual institutions.

Provision of Service

Procurement

4.11 There are a variety of ways of procuring an IAS which would meet the requirements of the Code. It is for the Governing Body, advised by its Audit Committee, to establish which is the most suitable and cost-effective way of obtaining the required service.

The options are as follows:

- Appoint a Head of Internal Audit Service (Head of IAS) and staff as necessary. An "in-house" team may also be supplemented from time to time with external consultants or contractors, under the direction of the Head of IAS, to meet any peaks in workload or to provide specialist skills;
- Form a consortium with one or more other institutions or other appropriate bodies. Consortia may be organised on an "in-house" basis or may be contracted to an external provider; or be a combination of the two; or
- Contract directly with an external provider, such as another institution, an accountancy firm, NHS body or local authority.

- 4.12 Governing Bodies need to be aware of the different roles and responsibilities of internal and external auditors. Since the IAS evaluates the institution's internal control systems, the external auditor **will** need to be satisfied that the internal audit function is being performed effectively. To maintain independence and objectivity, the same accountancy firm **must** not provide both internal and external audit services to the same institution.

Standards

- 4.13 The operation and conduct of the IAS **must** conform to the standards for internal audit which are laid down in the Auditing Guideline "*Guidance for Internal Auditors*" issued by the Auditing Practices Committee in June 1990, as updated and amended. Internal auditors **must** also have regard to relevant advice provided by professional auditing and accountancy bodies and any additional guidance which may be issued by the Council from time to time. Reference should also be made to the relevant sections of the Government Internal Audit Manual, issued by HM Treasury for guidance.

Quality Measurement and Assurance

- 4.14 The Head of IAS should, in conjunction with management and the Audit Committee, establish and implement performance measures and indicators, whereby the efficiency and effectiveness of the service can be monitored on an ongoing basis. In addition, and in order to discharge its responsibility for monitoring internal audit, the Audit Committee should review the efficiency and effectiveness of the IAS and, where the service is provided in-house, its compliance with relevant internal auditing policies and standards. The Committee should have regard to the performance measures and indicators used by the IAS for self-assessment and may also look to the external auditor to provide an independent assessment of internal audit's effectiveness. Examples of performance measures and indicators and guidance on their application and interpretation, are included in Annex E. However, it is the responsibility of each institution to adopt or develop a set of indicators which are relevant to its needs and circumstances.
- 4.15 In deciding on a portfolio of performance measures and indicators, an institution should assess the time and other resources involved in gathering the data and performing the calculations against the usefulness of the results achieved. Also, the portfolio should include an appropriate balance between output, input and quality based measures and indicators. Qualitative factors should be taken into account in interpreting results.
- 4.16 The Audit Committee's assessment of the effectiveness and efficiency of the internal audit service should inform the Governing Body's decision-making process in considering the re-appointment of the internal audit service if it is a contractual, rather than an in-house provision. Where the internal audit service is provided in-house the Audit Committee's assessment should inform the Governing Body's consideration as to whether this should continue to be the means of service delivery.

- 4.17 The internal audit service should consider benchmarking its results and performance against those of other institutions and other appropriate public or private organisations, either UK or overseas. The advantage of this option is that participants can be carefully selected from those in comparable institutions and sectors to ensure that comparisons are meaningful. It is more beneficial to concentrate on a few key benchmarks which reflect the Head of IAS's main priorities, than to attempt to benchmark all aspects of internal audit work. The Conference of Higher Education Internal Auditors (CHEIA) and the British Universities' Finance Directors' Group both collate certain benchmarking information pertaining to universities' audit arrangements and institutions should use the output from these exercises to help inform its evaluation of its IAS.
- 4.18 Benchmarking should enable the IAS and the Audit Committee to further determine and review the strengths and weaknesses of the internal audit service and thus identify areas for improvement and strengths to build upon.

Independence and Status

- 4.19 Independence enables internal auditors to appraise the internal control system in the impartial and unbiased manner essential to the proper conduct of audits. Recognition of the independence of internal audit is fundamental to its effectiveness. For the individual auditor, independence is essentially an attitude of mind characterised by integrity and an objective approach to work.
- 4.20 The Head of IAS should determine the Service's own priorities within a plan prepared after consultation with senior management and approved by the Governing Body, on the recommendation of the Audit Committee.

In considering the work to be undertaken by the IAS, the following key points **must** be considered:

- Internal auditors **must** avoid any official, professional and personal relationships or interests which might cause them to limit the extent, approach or nature of their audit.
- If the IAS is called upon to carry out specific investigations, such reviews **must** not compromise its objectivity or independence and should not, if avoidable, compromise significantly the achievement of its audit plan.
- The IAS, therefore, **must** be a separate function from the management of the institution and should not have any management responsibilities other than for internal audit.
- For day-to-day administrative purposes, an 'in-house' Head of IAS may be responsible to a senior officer within the institution. The administrative or line management reporting arrangements for the IAS **must** have due regard for preserving the independence and perceived independence of the IAS.
- To be effective, the Head of IAS **must** have sufficient status and be seen to have the respect and support of the institution's senior management as well as that of the Governing Body.

- The Head of IAS, or equivalent where the service is provided on a contract basis, **must** have direct access to the institution's Designated Officer and to the Governing Body, normally through the Chairman of the Audit Committee, and, if necessary, to the Chairman of the Governing Body. The Head of IAS **must** have right of access at any time to the Chairman of the Audit Committee. The Head of IAS may formally request the Chairman of the Audit Committee to convene an Audit Committee meeting.
- Internal audit **must** also have unrestricted access to all documents, records, assets, personnel and premises of the institution, and be authorised to obtain such information and explanations as considered necessary by the Head of IAS.

4.21 The Head of IAS should ensure that good communication is maintained between the IAS and the Chairman of the Audit Committee.

Planning

4.22 The work of the internal audit service should be planned at each level of operation and be based on the terms of reference approved by the Governing Body.

Audit Needs and Risk Assessment

4.23 Audit plans **will** be derived from a comprehensive audit needs assessment (ANA) prepared by the Head of IAS.

4.24 An ANA is a systematic aid to planning, the main output from which is an analysis of all financial systems and management systems concerned with the wider aspects of internal control as described in Paragraph 3.26. The purpose of the analysis is to assess systematically the audit need and to estimate the staff time required by grade of auditor against each system.

4.25 The ANA process involves:

- identifying all areas of work by system and sub-system;
- determining the way in which systems will be grouped for audit purposes;
- for each system and sub-system identifying key controls and associated risks; and
- determining the internal audit resource required to meet the identified audit needs

4.26 All parts of the institution and all of management's objectives **must** be considered when identifying systems and assessing audit need generally.

4.27 This should include the audit of all control systems and due regard should also be given to reviews of academic and other department reviews. Internal auditors should consult with management at appropriate levels to identify and define systems and sub-systems and to confirm internal audit's understanding of the institution's objectives and systems. The ANA should make provision for specific value-for-money studies, in which the IAS is to participate or to lead.

4.28 The ANA **must** be prepared without regard to constraints such as available time and other resources.

4.29 Once all systems have been identified, an assessment of risk associated with the systems will be performed by the IAS. The risk assessment process will assist the Head of IAS in determining the audit priorities to be proposed to the Audit Committee.

4.30 The ANA **must** be endorsed by the Audit Committee and approved by the Governing Body, or directly by the Audit Committee under delegated authority, and this approval **must** be minuted.

4.31 Internal audit plans will be based on the ANA, and will normally consist of three types:

- strategic plan;
- operational (usually annual) plan; and
- assignment (work) plans

4.32 Strategic and operational plans **must** be endorsed by the Audit Committee and approved by the Governing Body on the advice of the Audit Committee, or directly by the Audit Committee under delegated authority, and the approval **must** be minuted.

Strategic Plan

4.33 The Head of IAS **will** derive the strategic plan from the audit needs and risk assessments. The strategic plan **will** provide a broad outline of the work to be undertaken to meet internal audit objectives. It will show the allocation of audits as identified in the ANA over the current planning cycle. Both the strategic plan and the ANA **must** be reviewed regularly, at least annually, taking into account the results of audit work, development of new systems and any other risk factors which may affect the institution's priorities.

Operational Plan

4.34 The operational plan **will** be developed from the strategic plan, at least annually. The operational plan **will** provide additional detail regarding the definition of tasks to be performed and **will** identify critical areas, set target dates and allocate resources. It should be reviewed and updated as necessary during its term.

Assignment Plans

4.35 Assignment plans **must** be prepared for each audit undertaken, setting out the scope and objectives of the work, allocating resources and establishing target dates.

4.36 The Audit Committee has a duty to consider the scope, breadth and depth of coverage of assignment plans and should have a strategy for reviewing assignment plans. This may be done on a sample basis, for example, targeting high risk systems and may be conducted as part of the Committee's review of the IAS's assignment report rather than in advance of the assignment being conducted.

- 4.37 Once the internal audit plans have been agreed by the Audit Committee, or the Governing Body on the advice of the Audit Committee, the Head of IAS and management are required to ensure that the work covered by the plan is completed. Assignments should not be cancelled, significantly deferred or significantly reduced in their scope and objectives, without the agreement of the Chairman of the Audit Committee, and, if appropriate, that of the Governing Body. It may be appropriate for such agreement to be given retrospectively, depending upon the urgency of rescheduling issues, the significance of their impact on the achievement of the overall audit plan for the year, and the timing of Audit Committee meetings.

Resources

- 4.38 As part of the planning process the Head of IAS **must** advise the Audit Committee of the level of resources which he/she considers necessary to meet the approved annual audit plan. The Governing Body **must** determine, taking into account advice from its Audit Committee, and the level of risk which the Governing Body is willing to accept, whether the resources requested for internal audit appear to be reasonable. On the basis of this assessment, the Governing Body, or other body appropriate to the institution's planning and budgeting arrangements, should allocate resources accordingly.

- 4.39 Where the Head of IAS and the Governing Body or other appropriate body are unable to agree on a minimum level of resources to provide valid assurance, or where the level of resources approved by the Governing Body is, in the opinion of the institution's Head of IAS, insufficient, the Head of IAS **must** formally notify the Chairman of the Governing Body, the Chairman of the Audit Committee and the Designated Officer of this matter without delay.

- 4.40 Further guidance on audit planning is provided in the Government Internal Audit Manual.

Approach

- 4.41 The IAS should normally adopt a systems-based approach to evaluate the adequacy and effectiveness of the system of internal control as defined by the audit needs assessment. A system is a set of related activities designed to operate together to achieve a planned objective. The IAS should therefore identify the objectives of systems. Where stated management objectives are inadequate to characterise systems, the IAS should consult with management to establish appropriate objectives.
- 4.42 The Governing Body of an institution is required to ensure that the institution has sound systems of financial and other management controls. These are the systems of controls devised by management in order to ensure that:
- the institution's objectives are achieved;
 - there is compliance with relevant legislation and regulations, the Financial Memorandum between the institution and the Council, management's policies and directives, and terms attached to funding;

- the activities of the institution are carried out in an orderly and effective manner;
- resources are used in an economical, efficient and effective manner;
- the institution's assets and interests are safeguarded from losses of all kinds, including those arising from fraud, impropriety or corruption; and
- the integrity and reliability of accounting records, other information and data is secured, as far as reasonably practicable.

4.43 The prime objective of a systems based approach should be to evaluate the extent to which the controls in the system may be relied upon to ensure the objectives of the system are met. To achieve this the IAS should:

- identify and record objectives, activities and controls;
- evaluate the adequacy and effectiveness of controls, having regard to their economy and efficiency, and the operational risk in the system;
- test that the controls are satisfactorily operated; and
- arrive at conclusions supported by relevant, reliable and sufficient evidence and report them to management, together with recommendations to strengthen controls and compliance where appropriate. -

4.44 In performing systems auditing, the IAS should ensure that significant weaknesses identified in internal control systems are reported, along with the possible consequences, to the appropriate management without delay to enable corrective action to be taken as soon as possible.

4.45 Accordingly, the IAS **must** extend its review over all the financial and other management control systems, identified by the audit needs assessment process. It **must** cover all activities in which the institution has a financial interest, including those not funded by the Council. This coverage **will** extend to activities undertaken by the institution's subsidiary or associated companies, students' union and through joint ventures with third parties. For example, it should review controls, including investment procedures, that protect the institution in its dealings with such organisations.

4.46 Auditors should not question policy, but should consider the effects of management's policies, the arrangements by which policy decisions have been reached, including the extent to which they have been approved by the Governing Body and the means for delivering the related objectives. Whilst IAS should liaise with academic auditors regarding issues such as, for example, staffing, consultancy, research, registry and library, academic audit is not an activity performed by the IAS.

4.47 This approach should enable the IAS to reach the conclusions necessary to form an opinion on individual systems of internal control and on the internal control system overall, and to make necessary recommendations for improvement. Such opinions should be clearly reported in assignment reports and the IAS annual report. It is the Head of IAS's responsibility to draw attention to the Designated Officer and the

Audit Committee, the extent to which the Governing Body and the Designated Officer could be exposed by any shortcomings in the system under review. The degree of control should be related to the risks involved and it is management's role to exercise judgement in establishing the balance between risk and control.

Reporting

- 4.48 The reporting arrangements for internal audit should be determined by the institution after consideration by its Audit Committee. It is important that the reporting arrangements adopted, do not compromise the independence or objectivity of the IAS. Internal audit reports should be regarded as confidential and should only be supplied to those parties with a legitimate interest in their contents.
- 4.49 Internal audit should produce a draft report to line management of areas under audit normally within one month of the conclusion of each audit assignment. The draft report should set out the findings and recommendations arising and also an opinion on the adequacy and effectiveness of that part of the system of internal control reviewed.
- 4.50 All recommendations made in internal audit reports should be appropriately graded. The Head of IAS should formulate, with the approval of the Audit Committee, criteria for grading recommendations.
- 4.51 The draft report should normally be discussed with auditees and the factual accuracy agreed with them prior to issue of the final report. Auditees should be required to respond to audit reports within a specified period, stating their proposed action with a timed plan for implementing agreed recommendations and the person responsible for each action point.

4.52 This information **must** be incorporated in the final version of the report. Internal Audit **must** follow up recommendations to ensure that appropriate remedial action has been or **will** be taken within an acceptable timeframe. The outcome of this follow up should be reported to the Audit Committee.

4.53 The Head of IAS **must** produce an annual report on the IAS's activities.

4.54 The report should be addressed to the Governing Body and the Designated Officer and should be considered by the Audit Committee. The report should be for the institution's accounting period and be submitted to the Governing Body and Designated Officer when it is available, and to the Audit Committee in time for its first meeting of the following financial year. It is important that the Audit Committee receives the IAS's report in time to give it due consideration before producing its annual report to the Governing Body, as required in paragraph 3.22. As a minimum, the report by the Head of the IAS should include:

- the Head of IAS's opinion on the adequacy and effectiveness of the institution's internal control system, as defined in the Audit Needs Assessment. This opinion needs to be considered in a context in which audit coverage should be based on an objective assessment of risk underpinning the institution's Audit Needs Assessment. In arriving at an opinion the Head of IAS should take into account

findings and conclusions from the systems that have been audited during the year, as well as in previous years (including, as appropriate, opinions from previous auditors) and any known significant changes to the institution's risk profile that are likely to impact on future audit coverage.

- the Head of IAS's opinion on whether proper arrangements are in place to promote and secure value for money;
- an analysis of common or significant weaknesses arising;
- an executive summary of each IAS report;
- a comparison of the IAS's achieved performance during the year with that planned, placed in the context of the internal audit needs assessment and incorporating information regarding slippage/re-prioritisation of work during the year;
- details of any major audit findings where management action appears to be desirable but has not been taken, including that identified in previous years' IAS reports, and which, therefore, needs to be brought to the Governing Body's attention;
- the extent of achievement of any objectives (including targeted performance indicators) which may have been agreed for the internal audit service;
- an analysis of agreed performance indicators; and
- the operational plan for the year following the year in which the report is written, including narrative explanation of variances from strategic plan.

4.55 After consideration and approval by the Audit Committee, a copy of the IAS's annual report, together with the Audit Committee's comments thereon, **must** be provided by the institution to the Council within one month of its presentation to the Audit Committee and not later than 31 December following the financial year end to which the report relates.

4.56 The Head of IAS should be required to attend each Audit Committee meeting unless requested not to do so by the Chairman of the Audit Committee. The Head of IAS's right of access to the Chairman of the Audit Committee and to request meetings are referred to in paragraphs 3.17 and 4.20.

Relationship with Other Auditors

4.57 The Head of IAS should liaise with the institution's external auditors and may also liaise with FAMS to optimise and, if possible, enhance the level of service provided to the institution. The Audit Committee should regularly review the relationship between the internal and external auditors.

4.58 With the aim of achieving optimum coverage and avoiding duplication of work, whilst maintaining the independence of the external auditor, the Head of the IAS should arrange to meet periodically with the external auditors.

4.59 External auditors **must** be given access to IAS's working papers and plans so that their work programmes can take these into account and also so that the extent of their level of reliance on the work of the internal audit service can be determined.

4.60 Copies of the IAS's reports should be provided as a matter of course to the external auditor. The IAS should also receive copies of the external auditor's plans and management letters and any other relevant reports produced by other agencies for the institution.

4.61 FAMS **must** be allowed access to any work of the IAS or correspondence between the internal and external auditors. The terms of engagement for a contracted-out IAS should specify that FAMS **must** have access to the IAS's working papers without the need for an exchange of 'hold harmless' letters.

Change of Internal Audit Service Provider

4.62 The IAS's working papers and relevant audit documentation are the property of the institution. This **must** be made clear in the auditor's terms of engagement where the service is contracted out. In the event of a change of audit provider this should avoid costly duplication of work and ease transition.

4.63 The incoming IAS provider is likely to find it useful if institutions have arrangements for them to meet with the outgoing auditors. For institutions whose IAS is provided on a contract basis, such arrangements should be included in the terms of engagement.

Selection Criteria and Procedures

4.64 Whichever method of securing an IAS is adopted, the Governing Body should have regard to the personal qualities, expertise and experience of the leading individuals responsible for delivering the service. Key selection criteria should include:

- the relevant experience of the audit provider and, in particular, the relevant experience and expertise of the partner and audit manager responsible for the audit; and
- the audit fee rate, including a clear basis and formal mechanism for determining future fee rate increases.

4.65 Where the IAS is contracted out, the contract **will** be for a fixed period of time.

4.66 Whether the IAS is contracted out or provided in-house the Audit Committee should assess the IAS's work each year to ensure that the institution is obtaining value for money. A formal review of the provision of the IAS should be conducted regularly and also prior to the expiry of a contract period. As part of this review institutions should consider market testing the internal audit function to test more formally

whether best value for money is achieved. In the event of a change of internal audit provider, provision should be made for the outgoing auditors to complete their work and submit an annual report after expiry of the contract term or period of internal arrangement. Attendance by the auditors at the appropriate Audit Committee meeting should also be considered. Where there is a change of auditor, institutions should ensure that the new contract immediately follows the end of the old contract or other arrangements.

4.67 Where an institution externally contracts directly for its IAS, the selection process implemented should be the same as that for the selection of an external auditor and the criteria used **must** be fair, reasonable and well documented.

4.68 A key feature of the market testing process is that there should normally be a bid from the current provider of the service. The inclusion of the current provider in any market test, presupposes that the review of performance during the earlier period assessed this as satisfactory.

4.69 Consortia of institutions should agree upon tendering and selection procedures which follow the general principles stated above.

4.70 Market testing should be conducted in accordance with the institutions own purchasing procedures, taking account, where appropriate, of EC procurement requirements. The Audit Committee should appoint an Evaluation Committee which should consist of members of the Governing Body, management and representative of the Audit Committee. This committee should have overall responsibility for the market test and agree selection criteria, the scope of the audit work required and identify suitable potential providers.

4.71 When any appointment is agreed by the Governing Body the institution **must** inform FAMS of their selection and provide a copy of the engagement letter.

Removal or Resignation of Internal Audit Service Provider

4.72 Subject to normal staffing arrangements for 'in-house' auditors and any contractual arrangements in place, only the Governing Body (or the Audit Committee where authority has been delegated) may pass a resolution to remove the internal auditors before the end of their term of office. In passing such a resolution, the Governing Body or Audit Committee should be presented with a detailed case with all relevant facts explaining why this action is necessary.

4.73 The Governing Body **must** inform FAMS without delay of the removal or resignation of the Head of the IAS.

Restriction of Auditor's Liability

4.74 Where the IAS is contracted-out, the provider may ask the institution to agree to a restriction in the auditor's liability arising from any default by the auditor.

4.75 If an institution decides to accept a limitation of liability, then the decision **must** be made on an informed basis and recorded formally in the minutes of the institution's

Governing Body. The Governing Body, through the Audit Committee, should be specifically notified of any such request for a liability restriction.

Value for Money Auditing

- 4.76 Internal auditors may have a particular role to play, and responsibilities to undertake, in relation to value for money auditing and this is covered in some detail in Section 6 of the Code.

Improprieties, including Fraud and Corruption

- 4.77 On an operational basis, management has primary responsibility for preventing and detecting improprieties, including fraud and corruption (see paragraph 2.24). Management should institute adequate systems of internal control, including clear objectives, segregation of duties and authorisation procedures. The IAS assists management by examining and evaluating the adequacy and effectiveness of action taken to fulfil the obligation to prevent, detect and investigate impropriety, fraud and corruption. The IAS should have sufficient knowledge of fraud and its characteristics, the techniques used to commit fraud and the types of fraud associated with the activities audited.
- 4.78 It is not a primary function of the IAS to detect fraud. However, the work of the IAS should be planned to take into consideration the risk of impropriety, fraud, theft and corruption occurring, especially in those systems where a high potential for fraud exists. Systems should be tested to ensure that the risk of impropriety and fraud is minimised and auditors should be alert to any control weaknesses that allow impropriety or fraud to occur.
- 4.79 The Head of IAS should review management's written procedures on the action to be taken upon the discovery of fraud or irregularity and should make appropriate arrangements to be informed, as soon as possible, of all attempted, suspected or discovered fraud. The Designated Officer and the Chairman of the Audit Committee should also be informed immediately.
- 4.80 The institution should have a written policy on the process to be followed when evidence of potential impropriety, including fraud or corruption, is discovered. This may be set out in the institution's financial regulations or specified separately in a 'fraud policy statement'.

- 4.81 The Designated Officer of the institution **must** report to the Chairman of the institution's Audit Committee, the Chairman of the institution's Governing Body and the Council's Chief Executive, without delay, any serious weaknesses in internal control systems, significant fraud or major accounting or other control breakdown. If he or she does not undertake to do so, then the Head of IAS may report to them directly, without delay.

- 4.82 A serious weakness would be one which may result in a significant fraud or impropriety, and may include cases of irregularities in expenditure which could lead to suspicions of fraud.

4.83 The institution's IAS may be best placed to perform investigations into actual or suspected cases of fraud or impropriety. This is provided that:

- the IAS's objectivity or independence is not compromised;
- it has the appropriate skills and knowledge; and
- any decision taken on whether IAS should perform such investigatory work should consider appropriate risk assessment and whether IAS has sufficient resources to perform this additional work without detriment to its core work. Investigations should not, if avoidable, be performed by the internal audit service at the expense of planned internal audit work.

Further Information

4.84 The Council of Higher Education Internal Auditors (CHEIA) provides a forum for liaison and discussion between Heads of IAS and their teams with those of other higher education institutions to promote the sharing of ideas and good practice. The Head of IAS may find it useful to network with colleagues through CHEIA.

Control and Risk Self-Assessment (CRSA)

4.85 Control and Risk Self Assessment (CRSA) is a relatively new management technique which some organisations in the public and private sector use to assess the risks in their organisation and identify the controls needed to manage those risks. This can increase understanding of risk and control within an organisation, and so improve the efficiency and effectiveness of controls. The internal auditor, or an alternative facilitator, may help management to conduct a 'self-assessment'. There are a number of approaches to self-assessment; including questionnaire-based and workshop-based methods.

4.86 The advantages of self-assessment include the following:

- It strengthens management understanding both of risk, and of their responsibility for establishing and maintaining the internal control system needed to manage risk.
- It provides additional evidence for the external auditors, internal auditors, the Designated Officer and the Audit Committee in assessing the state of the internal control system.
- It can provide greater coverage of the control system than is normally feasible by the internal auditors alone, and could allow the internal audit service to reduce its routine work, so allowing greater focus on higher risk areas.
- It can enhance the relationship between management and the internal audit service. Although internal auditors can help management to establish, facilitate and review a self-assessment process, owning and operating it is still the responsibility of line management.

- 4.87 CRSA and the more traditional approach to internal audit are not mutually exclusive. Whilst it is for institutions to decide whether or not to use CRSA, the Council would encourage the use of self-assessment techniques to supplement, but not replace, internal audit work. The institution's Audit Committee should be specifically advised of the use of CRSA. Where appropriate, the use of CRSA should inform both the internal audit and Audit Committee annual reports.

SECTION 5

EXTERNAL AUDIT

Role of External Audit

5.1 The primary role of external audit is to report on the financial statements of institutions and to carry out such examination of the statements and underlying records and control systems as is necessary to reach their opinion on the statements. However, the audit of public funds extends further than that of the commercial sector since auditors must also be concerned with the requirements of the Funding Council and other funding bodies. Such requirements stem from the need for institutions to be publicly accountable for the public funds which they receive.

5.2 The external auditor's report **must**, therefore, also cover whether, in material respects, there has been compliance with all the terms and conditions attached to the funds provided to institutions.

5.3 Unless valid circumstances dictate otherwise, an institution's external auditor should also be appointed to perform the statutory audit of an institution's subsidiary companies.

Qualification of External Auditors

5.4 Institutions **must** ensure that their auditors are eligible for appointment as external auditors within the meaning and requirements of the Companies Acts.

5.5 Universities should also note that, under the Universities (Scotland) Act 1966, no person shall be qualified to be appointed as an external auditor who is, or any member of whose firm is, a member of the University Court or a member of the staff of the University. Institutions should consider all aspects of independence in the selection process.

Selection Criteria and Procedures

5.6 The Governing Body, as advised by its Audit Committee, **will** be responsible for appointing and re-appointing the institution's external auditors. Selection criteria and procedures should be determined in advance of receiving proposals and **must** be fair, reasonable and well-documented.

5.7 Key selection criteria should include:

- quality of service, including the relevant experience of the external audit firm and in particular the relevant experience and expertise of the partner and audit manager responsible for the audit; and
- the audit fee, including a clear basis and formal mechanism for determining future fee increases.

Letter of Engagement

- 5.8 The respective responsibilities of the Governing Body and the institution's external auditors should be documented clearly in agreed terms of reference. The terms of engagement letter should not depart in any material way from the model letter provided at Annex F. If any material differences are under consideration, FAMS should be consulted without delay.
- 5.9 The institution **must** send a copy of the letter of engagement and any subsequent changes to it to FAMS timeously.

Additional Services

- 5.10 To enable the objective review of internal audit by external audit, the same accountancy firm **must** not provide both internal and external audit services to the same institution.
- 5.11 The provision by the external auditor of additional services beyond the scope of the statutory audit, other than internal audit, is generally a matter for the institution to decide upon. An institution should agree the precise requirements of such additional work with the external auditors. The Audit Committee should be invited to consider the extent and nature of any non-statutory work to be undertaken, or which has been undertaken, depending on the circumstances. In doing so, the Committee should seek to balance independence and objectivity with the institution's needs. The external auditors should report any additional services which the firm has provided in an annual report to the Audit Committee.
- 5.12 In order to provide a basis on which to judge the relationship between an institution and its external auditors, the institution **must** disclose separately, by way of a note to its financial statements, the fees paid to its external auditor for other services.
- 5.13 Any additional work **must** not impair the independence of the external audit function and should, therefore, where appropriate, be the responsibility of different staff than those included in the external audit of the institution.

Audit Report

- 5.14 The external auditors shall report whether:
- the financial statements give a true and fair view of the state of the institution's affairs and of its income and expenditure and its cash flows for the year, taking into account relevant statutory and other mandatory disclosure and accounting requirements, including the Statement of Recommended Practice: Accounting in Higher Education Institutions, and any additional requirements of the Council;

- funds, from whatever source, administered by the institution for specific purposes have, in all material respects, been properly applied to those purposes and managed in accordance with any other terms and conditions attached to them; and
- income has in all material respects, been applied in accordance with relevant legislation and with the institution's Financial Memorandum with the Council.

5.15 In addition, institutions may ask the external auditors, usually through a separate letter of engagement, to review its statement of corporate governance included within the annual financial statements. In accordance with the terms of Circular Letter 5/99 (issued 29 January 1999), institutions are required to compare their existing governance practices with the Good Practice Benchmarks, issued as part of the Guide for Members of Governing Bodies, and publish the outcome in their annual report. The external auditors may report privately to the Governing Body (through the Audit Committee) on the results of their work or they may make reference to this review in the financial statements either in their audit opinion or through a separate report.

5.16 A model unqualified external audit report is provided at Annex G. Additional clauses may require to be inserted depending on specific circumstances existing at the time, in accordance with standards and guidance issued by the Accounting Standards Board and Auditing Practices Board.

Reporting Arrangements

5.17 The external auditor **will** be required to attend such meetings of the Audit Committee, as notified by the Secretary of the Audit Committee, in accordance with paragraph 3.17 of the Code.

5.18 The external auditor's right of access to the Chairman of the Audit Committee and right to request meetings are referred to in paragraph 3.17. The external auditor should also receive all notices of and other communications relating to any general meeting which any member of the Governing Body is entitled to receive, to attend any and to be heard at any general meeting which they attend, on any part of the business which concerns them as auditors.

5.19 The external auditor **must** also be entitled to attend the meeting of the Governing Body or other appropriate body to which the institution's annual report and financial statements are presented.

5.20 External audit should provide a management letter, within one month of issuing an opinion on the financial statements, highlighting any significant matters arising from the audit. The letter, with management's responses, should be made available (in draft if necessary) to the Audit Committee in time to inform the Committee's annual report.

5.21 Institutions **must**, within one month of receiving the Management Letter, send a copy of external audit's final Management Letter and management's responses thereto (if not already incorporated in the Letter) to the Council.

5.22 The external auditors **must** report in writing serious control weaknesses, significant frauds or irregularities or any major accounting breakdown to the Designated Officer, the Chairman of the Governing Body, the Chairman of the Audit Committee and the Chief Executive of the Council without delay. This process is necessary to assist the Chief Executive of the Council in fulfilling his responsibilities under the Financial Memorandum as Accounting Officer and to meet the accountability requirements detailed in Section 2 of this Code.

Reappointment and Review of External Auditors

5.23 The Governing Body should keep under review its external audit arrangements and **must** formally reappoint the external auditors each year.

5.24 In making its recommendation to reappoint or otherwise, the Audit Committee should assess the audit work each year to ensure that the institution is receiving a service of sufficiently high standard at a reasonable price. The Audit Committee should establish a formal review mechanism which includes the use of performance measures and indicators and benchmarking to facilitate the review of external audit. Factors to be considered should include the level of fees, number of audit hours provided, quality of service, including the content and timing of reports received, and the approach adopted by the external audit team.

5.25 The formal review of the external audit arrangements, including the quality and the extent to which they provide value for money, **must** be conducted by the Audit Committee at least every three years, or sooner if the service is considered to be unsatisfactory or not representing good value for money.

5.26 It is for each institution to adopt a set of measures and indicators appropriate to its needs and circumstances. In addition the Audit Committee should conduct a market testing exercise of the external audit service every five years, at least. The outcome of both exercises should be formally documented and reported to the Governing Body for its endorsement.

Removal or Resignation of Auditors

5.27 The Governing Body may by resolution remove the auditors, without compensation, before the end of their term of office in the event of serious shortcomings being identified.

5.28 External auditors who have resigned or been removed from office **must** be entitled to attend, or make representations to, the meeting of the Governing Body at which their term of office would otherwise have expired, or at which it is proposed to fill the vacancy caused by the resignation or removal. They should receive notices of, or

other communications relating to, the meeting and should be heard on any part of the business which concerns them as former auditors of the institution.

- 5.29 Where auditors cease to hold office for any reason during their term of appointment, they should provide the Governing Body with either a statement of any circumstances connected with their removal which they consider should be brought to the Governing Body's attention, or a statement that there are no such circumstances. The auditors may also requisition a special meeting of the Governing Body to consider the statement. These provisions are analogous to those of the Companies Acts.

- 5.30 The Governing Body **must** inform FAMS without delay of the removal or resignation of the auditors. In addition, FAMS **must** be sent a copy of any statement provided to the Governing Body by the outgoing auditors.

- 5.31 In order to decide whether or not to accept the appointment, any firm proposing to take up office as external auditor should obtain the institution's permission to communicate with the outgoing auditors. In the same way, outgoing auditors should obtain permission from the institution to discuss its affairs freely with the proposed auditors and should disclose fully all information required by the proposed auditors which is relevant to the appointment. These provisions are in accordance with the ethical guidance published by the professional accountancy bodies.

Relationships with Other Auditors

- 5.32 The external auditors should liaise with the institutions' Head of the IAS to review and discuss the work of the IAS to determine the extent to which the external auditors will rely on the results of this work. Paragraphs 4.57 to 4.61 provide more information on the liaison required between the external and internal auditors.

The Council's Access to External Auditors

- 5.33 On occasion, FAMS may wish to meet with institutions' external auditors. Formal discussions with external auditors will normally be arranged by FAMS through the institution, as appropriate.

- 5.34 Access to their external auditors **must** not be limited in any way by the institution.

- 5.35 The external auditors, notwithstanding responsibilities to their clients, **must** co-operate fully with any enquiries or routine monitoring that the Council undertakes.

Restriction of Auditor's Liability

- 5.36 Institutions **must** not agree to any restriction in liability in respect of the audit of their annual financial statements. 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.

- 5.37 For other types of work performed by the external auditor, the provider may ask the institution to agree to a restriction in the auditors' liability arising from any default by

the auditor. Normally, such liability should be without limit. However, institutions may negotiate a restriction in liability so long as the decision is made on an informed basis. The Governing Body, through the Audit Committee, should be notified of any liability restriction agreed.

SECTION 6

VALUE FOR MONEY

Background

6.1 The Financial Memorandum between the Council and each institution places responsibility on the institution's Governing Body to establish arrangements to secure the economic, efficient and effective management of the institution's resources. To meet this responsibility, the Governing Body **must** ensure that there are in place sound controls for planning, appraisal, authorisation and control of the use of resources.

6.2 The term 'value for money' (VFM) is commonly used to describe the combination of economy, efficiency and effectiveness:

ECONOMY means minimising the cost of resources acquired or used, bearing in mind the quality, i.e. spending less;

EFFICIENCY covers the relationship between the output of goods or services and the resources used to produce them, i.e. spending well; and

EFFECTIVENESS covers the relationship between the intended and actual results of projects and programmes, i.e. spending wisely.

Strategy

6.3 Securing and improving VFM is an important objective of a Governing Body and responsibility for its achievement lies primarily with management. The controls which management should have in place cannot be rigidly defined but some of those most directly concerned with VFM are:

- planning, including a clear definition of objectives and targets;
- availability of accurate and reliable management information on a timely basis;
- performance measures and indicators and the use of benchmarking to evaluate performance;
- policy and programme evaluation, including post implementation review; and
- identification of resource consumption and accountability.

6.4 The institution **must** have a strategy for systematically reviewing management's arrangements for securing VFM. The strategy **will** usually be defined by senior management in consultation with the Audit Committee and the Governing Body. The resource requirements for VFM auditing **must** be incorporated in the audit needs assessment and appropriate provision thereby made for the audit and other resources required.

6.5 The Audit Committee should ensure that a reasonable amount of time is provided for in the audit planning process to facilitate the provision of resources to undertake or participate in unplanned ad hoc VFM studies or other investigatory studies as required. When planning specific VFM studies, care should be taken to ensure that neither the position of internal audit, nor the achievement of its systems audit plan, are compromised. To avoid such problems, the audit needs assessment and strategic and annual audit plans should provide for adequate audit resources for performing specific VFM reviews. The scope, terms of reference and approach to be adopted for VFM studies will usually be unique to each study.

6.6 The internal audit service's precise role and responsibilities **must** be defined in the terms of reference for each study and the terms agreed with management prior to the work commencing.

6.7 There is a role for the Audit Committee, the Head of IAS and the external auditor in advising the Governing Body on potential topics for inclusion in the programme of VFM studies. They could also provide a view on the party most appropriate to undertake individual assignments, considering the required expertise and experience.

Role of the Audit Committee

6.8 The Audit Committee's responsibility as regards VFM is to monitor the effectiveness of the institution's arrangements to secure economy, efficiency and effectiveness which are put in place by management. This task could be undertaken by the Audit Committee endorsing and overseeing the implementation of a strategy to systematically review the achievement of VFM on an on-going basis. The process should include the Audit Committee's consideration of the institutional VFM strategy, and the review of reports which cover compliance with the strategy. The Audit Committee may decide to delegate this task to a sub-group. Any such sub-group should consist of one or more members of the Audit Committee plus multi-disciplinary representatives who would be co-opted from time to time to ensure that the sub-group has appropriate technical skills to enable the areas of review to be assessed effectively.

Role of Internal Audit Service and the External Auditor

6.9 The role of the internal audit service in relation to VFM auditing is twofold:

- as an integral part of its responsibility to evaluate the internal control system, internal audit **must** examine and evaluate the controls established by management to secure economy, efficiency and effectiveness; and

- internal auditors may conduct or participate in specific VFM studies.

6.10 The IAS's terms of reference should make it clear that the scope of internal audit work includes evaluation of management's procedures in regard to securing economy, efficiency and effectiveness. In evaluating controls, internal audit should also make a judgement as to the effectiveness of management's arrangements for

assessing and managing relevant risks as well as the relative cost of operating the controls. This should be reflected in the IAS's terms of reference.

6.11 Over the complete audit cycle internal audit **must** provide a comprehensive appraisal of management's arrangements for achieving VFM.

Specific VFM Studies

6.12 Individual VFM studies involve the direct consideration and examination of the results achieved by specific activities. The objectives of such reviews extend beyond the internal audit objectives of evaluating the internal control system. The internal audit service's terms of reference should therefore identify separately any responsibility it may have for initiating, conducting or participating in such studies. The scope and nature of such studies will vary but they may have some or all of the following characteristics:

- to examine the results achieved by activities;
- to judge whether good value for money has been achieved;
- to identify instances of waste or other examples of poor value for money; and
- to identify ways of improving value for money.

6.13 In view of their independence and professional expertise in review, analysis and investigative work, internal auditors are often regarded as particularly suitable for conducting or assisting with specific VFM studies. Institutions should consider the extent to which it is appropriate to engage internal audit staff to lead and/or participate in each specific study. In some instances other institutional staff with appropriate expertise or independent specialists may be engaged either to manage or participate in VFM studies.

National VFM Studies

Higher Education UK VFM Initiative

6.14 The four UK higher education funding bodies have developed and implemented a joint UK sector-wide programme of VFM studies - '*Higher Education UK VFM Initiative*'. This initiative marks an important stage in the development of co-operation within the sector; between institutions, the funding bodies and third parties. The work is undertaken under the direction of the UK Value for Money Steering Group which consists of sector representatives from throughout the UK and is normally chaired by a Vice-Chancellor or Principal of an institution.

6.15 The underlying philosophy of the VFM initiative is that studies will be conducted for the benefit of the sector and a programme of studies has been developed following consultation with the sector. The role of such national studies will be to disseminate good practice and to support institutions conducting their own reviews at a local level.

6.16 The products of each of these studies are normally a national report and an accompanying management review guide. The review guide is intended to enable the executive management of an institution to undertake a systematic and comprehensive

review of its institution's arrangements and to compare these with the examples of best practice identified by the national study.

- 6.17 The national studies will be subject to periodic follow up to determine the extent to which good practice is being adopted in the sector. In addition FAMS will, as part of its work during institutional visits, critically review the impact of national VFM studies at a local level and the mechanisms adopted by institutions for considering and implementing study recommendations.
- 6.18 Further, the Council may conduct or facilitate specific value for money studies in the Scottish sector. Any such studies will be for the benefit of the sector and will only be undertaken after appropriate consultation.
- 6.19 When planning specific VFM studies, account should be taken of the national studies which have been conducted to-date. A list of these studies which have been carried out under the UK VFM initiative, as well as the National Audit Office, is provided in Annex H and I and FAMS will send institutions updates of this annex as further studies are completed.

Dissemination of Good Practice Guidance

- 6.20 The Governing Body, as advised by the Audit Committee, should establish institutional procedures to ensure that good practice arising from VFM studies, both institutionally and nationally conducted, is appropriately disseminated within the institution.

SECTION 7

FINANCIAL APPRAISAL AND MONITORING SERVICES

Role and Scope of FAMS

- 7.1 The Financial Memorandum between SEELLD and the Council requires the establishment of an audit function by the Council. This audit function is discharged by the Council's Financial Appraisal and Monitoring Service (FAMS). FAMS is responsible for evaluating the Council's control arrangements in accordance with an Audit Needs Assessment (as defined in Paragraphs 4.24 to 4.30) approved by the Council's Audit Committee. It is the responsibility of FAMS to provide assurance to the Council's Chief Executive, as Accounting Officer, and the Council's Audit Committee on the effectiveness of those control arrangements.
- 7.2 A key responsibility of FAMS is to establish and develop a process for monitoring the effectiveness of institution's financial and management control and audit arrangements. FAMS has no executive role within institutions, nor does it have any responsibility for the development, implementation or operation of their systems. It may, however, from time to time provide advice and guidance to institutions on control and related matters, subject to the need to maintain objectivity.
- 7.3 All institutions receiving funding from the Council fall within the scope of FAMS's review. Rights of access to undertake examination of financial and management controls are provided for in the Financial Memorandum between the Council and each institution.

Institutional Reviews

Approach

- 7.4 In carrying out its responsibilities for monitoring the effectiveness of institutions control arrangements, FAMS will undertake a cycle of visits to each institution to review the key financial and management controls in operation across a range of activities, in particular, finance and audit.
- 7.5 The institutional reviews of control arrangements are intended to be completed within one week and are currently conducted on a three yearly cycle.
- 7.6 The overall objectives of the reviews are:
- to assess the effectiveness of the operation of the institutions' key arrangement controls, in particular those relating to the audit and finance functions; and
 - to assess the institutions compliance with good practice and related guidance.

7.7 In order to do this FAMS will:

- meet with members of the institution's senior Executive;
- review the activities of the internal audit function including audit planning and reporting arrangements; and meet with the internal auditor;
- review the external audit arrangements, including all relevant documentation and meet with the external auditor;
- review the activities of the Audit Committee through an examination of its minutes and its annual report to Governing Body; and meet with the Chair of the Audit Committee;
- review the activities of the Finance Committee, through an examination of its minutes;
- review the budget setting process and financial reporting arrangements and meet with the Finance Officer and the Chair of the Finance Committee; and
- review the activities of the Governing Body through an examination of its minutes.

7.8 FAMS may also, after appropriate liaison, carry out ad hoc investigations at an institution on perceived areas of high risk.

7.9 An overview of the objectives and approach to FAMS institutional reviews and an indication of the pre-visit information requested are given at Annex J and K respectively.

Access

7.10 Through the provisions of the Financial Memorandum, FAMS has access to all of an institution's records, information and assets and can require any officer to give any explanation which it considers necessary to fulfil its responsibilities.

Reporting

7.11 Before concluding the visit FAMS will discuss key findings with the institution and agree these as factually accurate. FAMS should issue a draft report within one month of completion of each review. The report will give an opinion on the area reviewed and make recommendations to the institution's management, where appropriate. Each report will include an agreed action plan for improvement and material recommendations will be followed up by FAMS. All reports will be copied to the Council's Chief Executive. FAMS should communicate promptly to the institution's external and internal auditors any significant problems detected as a result of its review.

Liaison

- 7.12 FAMS will liaise, whenever appropriate, with the National Audit Office, SEELLD, institutions' internal and external auditors, the Higher Education Funding Council for England, the Higher Education Funding Council for Wales, the Department of Education for Northern Ireland and with colleagues in the Council.

MODEL DESCRIPTION OF THE RESPONSIBILITIES OF THE GOVERNING BODY

Responsibilities of the Governing Body of [Institution]

In accordance with the [relevant legislation of incorporation], the Governing Body of [Institution] is responsible for the administration and management of the affairs of the [University/College] and is required to present audited financial statements for each financial year.

The Governing Body is responsible for ensuring that proper accounting records are maintained which disclose with reasonable accuracy at any time the financial position of the [University/College] and to enable it to ensure that the financial statements are prepared in accordance with the [relevant legislation of incorporation], the Statement of Recommended Practice: Accounting in Higher Education Institutions and other relevant accounting standards. In addition, within the terms and conditions of a Financial Memorandum agreed between the Scottish Higher Education Funding Council and the Governing Body of [Institution], the Governing Body, through its designated office holder, is required to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the [University/College] and of the surplus or deficit and cash flows for that year.

In causing the financial statements to be prepared, the Governing Body has to ensure that:

- suitable accounting policies are selected and applied consistently;
- judgements and estimates are made that are reasonable and prudent;
- applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- the financial statements are prepared on the going concern basis, unless it is inappropriate to presume that the [Institution] will continue in operation.

The Governing Body has a responsibility to:

- ensure that funds from the Scottish Higher Education Funding Council are used only for the purposes for which they have been given and in accordance with the Further and Higher Education (Scotland) Act 1992, the [University's/College's] Financial Memorandum with the Funding Council and any other conditions which the Funding Council may from time to time prescribe;
- ensure that there are appropriate financial and management controls in place to safeguard public funds and funds from other sources;

- safeguard the assets of the [University/College] and hence to take reasonable steps to prevent and detect fraud;
- ensure reasonable steps have been taken to secure the economical, efficient and effective management of the [University's/College's] resources and expenditure; and
- ensure sound corporate governance and the proper conduct of the [University's/College's] operations.

GUIDANCE ON THE DUTIES OF THE AUDIT COMMITTEE

The following provides a summary of the main duties of the Audit Committee

Internal Control

- reviewing and advising the Governing Body of the IAS's and the external auditor's assessment of the effectiveness of the institution's financial and other internal control systems, including controls specifically to prevent or detect fraud or other irregularities as well as those for securing economy, efficiency and effectiveness; and
- reviewing and advising the Governing Body on its compliance with corporate governance requirements and good practice guidance.

Internal Audit

- advising the Governing Body on the selection, appointment or reappointment and remuneration, or removal of the IAS provider where the service is contracted-out (paras 4.11, 4.12, and 4.72 to 4.75 refer). The responsibility regarding selection of a contracted-out provider may be delegated to an Evaluation Committee (para 4.70 refers);
- advising the Governing Body on the terms of reference for the IAS (paras 4.7 and 4.8 refer);
- reviewing the scope, efficiency and effectiveness of the work of internal audit, considering the adequacy of the resourcing of internal audit and advising the Governing Body on these matters (paras 4.9 and 4.38 to 4.39 refer);
- advising the Governing Body of the Audit Committee's approval of the basis for and the results of the internal audit needs assessment and the strategic and operational planning processes (paras 4.23 to 4.34 refer);
- approving the criteria for grading recommendations in assignment reports as proposed by the Head of IAS (para 4.35 and 4.40 refers);
- reviewing the IAS's monitoring of management action on the implementation of agreed recommendations reported in internal audit assignment reports and internal audit annual reports (para 4.50 refers);
- considering salient issues arising from internal audit assignment reports, progress reports, annual reports and management's response thereto and informing the Governing Body thereof (paras 4.48 to 4.52 refer);
- informing the Governing Body of the Audit Committee's approval of the internal audit service's annual report (paras 4.53 to 4.56 refer);

- ensuring establishment of appropriate performance measures and indicators to monitor the effectiveness of the IAS (paras 4.14 to 4.18 refer);
- securing and monitoring appropriate liaison and co-ordination between internal and external audit (paras 4.57 to 4.60 refer);
- ensuring good communication between the Committee and the Head of IAS (para 4.21 refers); and
- responding appropriately to notification of fraud or other improprieties received from the Head of IAS or other persons (para 4.79 to 4.85 refers).

External Audit

- advising the Governing Body on the selection, appointment, annual reappointment and remuneration, or removal, of the external auditors and the scope of their work (paras 5.6 to 5.9 refer). The responsibility regarding selection may be delegated to an Evaluation Committee.
- considering the institution's annual financial statements and the external auditor's report prior to submission to the Governing Body by the Finance Committee. Care should be taken, however, to avoid undertaking work that properly belongs to the Finance Committee. If within its terms of reference, the Committee should consider the external audit opinion, the Statement of Members' Responsibilities and any relevant issue raised in the external auditor's management letter;
- reviewing the external auditor's annual Management Letter and monitoring management action on the implementation of the agreed recommendations contained therein (para 5.20 refers);
- advising the Governing Body of salient issues arising from the external auditor's management letter and any other external audit reports, and of management's response thereto (paras 5.20 to 5.22 refer);
- reviewing the statement of corporate governance (para 5.15 refers);
- establishing appropriate performance measures and indicators to monitor the effectiveness of the external audit provision (para 5.23 to 5.26 refers);
- reviewing the external audit strategy and plan;
- holding discussions with external auditors and ensuring their attendance at Audit Committee and Governing Body meetings as required (paras 5.17 to 5.19 refer);
- considering the objectives and scope of any non-statutory audit work undertaken or to be undertaken, by the external auditor's firm and advising the Governing Body of any potential conflict of interest (para 5.10 and 5.11 refer); and

- securing appropriate liaison and co-ordination between external and internal audit (paras 5.32 to 5.35 refer).

Value for Money

- establishing and overseeing a review process for evaluating the effectiveness of the institution's arrangements for securing the economical, efficient and effective management of the institution's resources and the promotion of best practice and protocols (para 6.1 to 6.8 refer), and reporting to the Governing Body thereon;
- advising the Governing Body on potential topics for inclusion in a programme of value for money reviews and providing a view on the party most appropriate to undertake individual assignments considering the required expertise and experience (paras 6.4 to 6.8 refer); and
- advising the Governing Body of action that it may wish to consider in the light of national value for money studies in the higher education sector (para 6.14 to 6.20 refer).

Advice to the Governing Body

- reviewing the institution's compliance with the Code and advising the Governing Body on this;
- producing an annual report for the Governing Body, as described in paragraph 3.23;
- advising the Governing Body of significant, relevant reports from the Council and NAO and successor bodies and, where appropriate, management's response thereto; and
- reviewing reported cases of impropriety to establish whether they have been appropriately handled.

RECOMMENDED MATTERS FOR INCLUSION IN THE AUDIT COMMITTEE'S ANNUAL REPORT TO THE GOVERNING BODY

It should be ensured that the content of the Report meets the requirements of the Committee's Terms of Reference and addresses all significant issues arising.

Administrative Matters

- Financial period covered.
- Membership details, including changes in membership and chairmanship.
- Dates of meetings and details of attendees if useful or appropriate.
- Details of any changes to the terms of reference and their effect on the work of the Committee.

Internal Audit

- Name of provider and fee basis if contracted-out.
- Review of the IAS's annual report (which should be attached to the Audit Committee's annual report) including its achievement of planned work. Comment on the IAS's opinion on the effectiveness of the institution's systems of internal control, as defined in terms of an Audit Needs Assessment (referred to in Paragraphs 3.26 and 4.24 – 4.30).
- Review of internal audit's scope and an assessment of its performance and effectiveness during the year.
- Following year's agreed operational audit plan.
- Review of appointment.
- Review of audit needs assessment, strategic plan and annual plan. Details of any restrictions placed upon the work of the IAS.
- Review of planned audit reports including details of significant findings and recommendations, along with the Audit Committee's view of management's responses to the findings and recommendations. Details of any significant recommendations outstanding. Same information for unplanned audit assignments.

EXTERNAL AUDIT

- Name of provider and fee basis.
- Scope of audit and Audit Committee's assessment of performance for year. Results of tri-annual formal internal review.
- Confirmation to Governing Body of recommendation of annual re-appointment.
- Review of the audited financial statements including accounting policies, disclosures and the external auditor's audit opinion.
- Review of the external auditor's management letter including management's responses to findings and recommendations.
- Review of statement of corporate governance, where prepared and audited.

VALUE FOR MONEY PROGRAMME

- Report on the effectiveness of management's VFM arrangements.
- Summary of studies conducted and significant results.
- Following year's proposed studies.

Other Matters

- Summary of relevant Funding Council reports, letters and other requirements and consultations.
- Financial and control systems development.
- Audit and finance issues arising regarding trusts, joint ventures, subsidiary or associated companies.
- Review of relevant NAO and other reports.
- Fraud and irregularity issues.
- Issues not relevant to the reporting year eg forthcoming events, issues relating to prior years.

OPINION

- The Committee's opinion on the adequacy and effectiveness of the institution's internal financial and management systems (as defined in the Audit Needs Assessment referred to in Paragraphs 3.26 and 4.24 – 4.30), and on the adequacy and effectiveness of the arrangements for securing economy, efficiency and effectiveness. These opinions are to be based on the assessments provided to the Audit Committee by the external auditors and the IAS.
- The Committee's view on whether the Governing Body's responsibilities, as described in the Responsibilities of the Governing Body Statement, have been satisfactorily discharged.

The Committee's view on whether the Council's Code of Audit Practice has been complied with.

MODEL TERMS OF REFERENCE FOR AN INTERNAL AUDIT SERVICE

1. The Internal Audit Service is responsible for conducting an independent appraisal of all the institution's activities, financial and otherwise with the exception of the academic process. It should provide a service to the whole organisation, including the Governing Body and all levels of management. It is not an extension of, nor a substitute for, good management. The Internal Audit Service is responsible for giving assurance to the institution's Governing Body and Designated Officer on the control arrangements as defined in the approved audit needs assessment. It also assists management by evaluating and reporting to them on the effectiveness of the controls for which they are responsible. It remains the duty of management, not the internal auditor, to operate an adequate system of internal control. It is for management to determine whether or not to accept audit recommendations and to recognise and accept the risks of not taking action.

Scope

2. All the institution's activities, funded from whatever source, fall within the scope of the Internal Audit Service. The Internal Audit Service **will** consider the adequacy of controls necessary to secure propriety, economy, efficiency and effectiveness in all areas. It **will** assess whether management has taken the necessary steps to achieve these objectives. The scope of internal audit work should cover all operational and management controls, including those at departmental level, and should not be restricted to the audit of those systems and controls necessary to form an opinion on the financial statements. This does not imply that all systems **will** be subject to review, but that all **will** be included in the audit needs assessment and hence considered for review in the context of assessed risk. The audit needs assessment **will** therefore be prepared initially without regard to constraints such as the time and resources which may be available.
3. The scope and detail of the terms of reference **must** be such that they enable the Head of the IAS to provide the Governing Body with the appropriate quality of assurance on the adequacy, reliability and effectiveness of the institutions internal control system.
4. The Head of IAS **must** advise the Governing Body of the risks to which it, and the institution, may be exposed if the scope of the audit coverage is limited in any way. Where the Head of IAS believes that any limitations are unacceptable, his or her views and opinion on the associated risks **must** be formally reported to the Chairman of the Governing Body, the Chairman of the Audit Committee and the Designated Officer.
5. It is not within the scope of the Internal Audit Service to question the appropriateness of policy decisions. However, the Internal Audit Service is required to examine the arrangements by which such decisions are made, monitored and reviewed.

6. The Internal Audit Service may also conduct any special reviews requested by the Governing Body, Audit Committee or Designated Officer, provided such reviews do not compromise its objectivity, independence or achievement of the approved audit plan.

Responsibilities

7. The Head of the Internal Audit Service should give an annual opinion to the Audit Committee, on the adequacy and effectiveness of the internal control system as defined in the audit needs assessment, including those controls for economy, efficiency and effectiveness within the institution, and the extent to which the Governing Body can rely on such systems. He or she should also comment on other activities for which the Governing Body is responsible, and to which the Internal Audit Service has access.
8. To provide the required assurance the Internal Audit Service **will** undertake a programme of work over a cycle authorised by the Governing Body on the advice of the Audit Committee, or directly by the Audit Committee under delegated authority. The programme **will** have the following objectives:
 - a. To appraise the soundness, adequacy and application of the whole internal control system.
 - b. To ascertain the extent to which the system of internal control ensures compliance with established policies and procedures.
 - c. To ascertain the extent to which the assets and interests entrusted to, or funded by, the institution are properly controlled and safeguarded from losses arising from improprieties, including fraud, irregularity or corruption.
 - d. To ascertain that accounting and other information is reliable as a basis for producing accounts, and financial, statistical and other returns.
 - e. To ascertain the integrity and reliability of financial and other information provided to management, including that used in decision making.
 - f. To ascertain that systems of control are laid down and operate to promote the economic, efficient and effective use of resources.

Approach

9. The Internal Audit Service's work **will** be performed with due professional care, in accordance with appropriate professional auditing practice. It should have regard for the relevant sections of the Government Internal Audit Manual, and **will** comply with the Council's Code of Audit Practice.
10. In achieving its objectives, the Internal Audit Service should:
 - a. Identify all elements of control systems on which it is proposed to rely, and establish a review cycle.

- b. Evaluate those systems, identify inappropriate or inadequate controls, and recommend improvements in procedures or practices.
- c. Ascertain that those systems of control are laid down and operate to promote the most economic, efficient and effective use of resources.
- d. Draw attention to any apparently uneconomical or otherwise unsatisfactory result flowing from decisions, practices or policies.
- e. Liaise with external auditors, and with the Council's Financial Appraisal and Monitoring Service (FAMS).

Independence

- 11. The Internal Audit Service has no executive role, nor does it have any responsibility for the development, implementation or operation of systems. However, it may provide advice on implementation, control and related matters, subject to resource constraints and the need to maintain objectivity. For day-to-day administrative purposes only, the Head of the Internal Audit Service should report to a senior officer within the institution. (The reporting arrangements should take account of the nature of audit work undertaken).
- 12. Within the institution, responsibility for internal control rests fully with management, which should ensure that appropriate and adequate arrangements exist without reliance on the institution's Internal Audit Service. To preserve the objectivity and impartiality of the internal auditors' professional judgement, responsibility for implementing audit recommendations rests with management.

Access

- 13. The Internal Audit Service has rights of access to all of the institution's records, information and assets which it considers necessary to fulfil its responsibilities. Rights of access to other bodies funded by the institution should be set out in the conditions of funding. The Head of the Internal Audit Service has a right of direct access to the Chairman of the Governing Body, the Chairman of the Audit Committee and the Designated Officer. The Internal Audit Service **will** agree to comply with any requests from the external auditors and the Council's FAMS for access to any information, files or working papers obtained or prepared during our audit work that they need to discharge their responsibilities.

Reporting

- 14. The Head of the Internal Audit Service must submit an annual report to the Governing Body and Designated Officer through the Audit Committee, based on the institution's financial year. This should give an opinion on the internal control at the institution, and on the arrangements for securing economy, efficiency and effectiveness as defined in the audit needs assessment. The Head of the Internal Audit Service should also prepare, before the beginning of the year, a long-term strategy document supported by an audit needs assessment, and an annual audit plan. These should be

submitted to the Governing Body for approval following consultation with relevant managers and the Designated Officer, and after consideration by the Audit Committee. Alternatively, the Governing Body may delegate authority to the Committee to approve the plans.

15. The Head of the Internal Audit Service is accountable to the Designated Officer and the Governing Body through the Audit Committee for the performance of the Service. He or she should also report audit findings to relevant managers (including the Designated Officer) and draw the attention of the Audit Committee to key issues and recommendations. This may be done by providing the Committee with copies of all reports, or by reporting on an exception basis or by providing a summary of key issues.
16. The Internal Audit Service should usually produce its reports, in writing, within one month of completion of each audit, giving an opinion on the system reviewed and making recommendations to improve systems where appropriate. Such reports should be copied to the Designated Officer and may be copied to the Audit Committee. Managers **will** be required to respond to each audit report, usually within one month of issue, stating their proposed action with a timetable for implementing agreed recommendations. Material recommendations **will** usually be followed up some six to twelve months later. In addition, the Audit Committee **will** monitor the implementation of audit recommendations.
17. The Head of the Internal Audit Service should report to the Designated Officer any serious weaknesses in internal control systems, significant fraud, or major accounting or other control breakdown discovered during the normal course of audit work. If the Designated Officer does not undertake to report the matter to the Council's Director of FAMS, the Chairman of the Audit Committee and the Chairman of the Governing Body, then the Head of Internal Audit Service may report to them directly.

Standards

18. The operation and conduct of the Internal Audit Service **must** conform to the standards in the Auditing Guideline 'Guidance for Internal Auditors', issued by the Auditing Practices Committee in June 1990. Internal auditors **must** also have regard to relevant advice provided by professional auditing and accountancy bodies, and any guidance produced by the Council. Reference should also be made to the relevant sections of the Government Internal Audit Manual, issued by HM Treasury for Guidance.
19. The Head of Internal Audit Service should implement measures to monitor the effectiveness of the service and compliance with standards. In addition, the Audit Committee should consider and approve the performance measures and indicators used by internal audit, and should also consider asking the external auditor to provide an independent assessment of internal audit's effectiveness.

Liaison

20. The Internal Audit Service **will** liaise with the external auditors and the Council's FAMS to enhance the level of service it provides to the institution.

EXAMPLES OF PERFORMANCE MEASURES AND INDICATORS FOR INSTITUTION'S INTERNAL AUDIT SERVICE

1. The table below contains examples of performance measures and indicators for monitoring the performance of the internal audit service. A frequency of monitoring has been suggested for each measure or indicator. The examples are not prescriptive or exhaustive and are not necessarily appropriate to all institutions. It is for each institution to adopt or develop a set of measures and indicators which are appropriate to its needs and circumstances.
2. In many instances, measures and indicators contain a large degree of subjective opinion and the results **must**, therefore, be carefully interpreted and a broad, balanced view taken. Undue emphasis or reliance placed upon any single measure or indicator or group of measures or indicators **will** inevitably lead to a distorted view.
3. The results of benchmarking **must** always be considered in the context of the environment and the constraints within which the exercise is conducted. Comparative measures can be made against either the average achieved by participants in the benchmarking scheme, or against the best result achieved.
4. Measures and indicators should be regularly reviewed to ensure they remain relevant to needs and are being used effectively.
5. Structured questionnaires permit easier evaluation by assigning scores to the response for each aspect of the audit. Bias can be reduced by sending questionnaires on the same audit to various levels of management. Such measures/indicators should be used with caution as results **will** be subjective. A better appraisal may be informed by aggregating a number of audits over time. Also, care should be taken to avoid creating conditions that inhibit the reporting of controversial recommendations.

Table 1: Examples of Performance Measures and Indicators and Frequency of Monitoring overleaf:

MEASURE/INDICATOR	TIMING
<i>Provision of service</i>	
<ul style="list-style-type: none"> • Cost of service year on year within contract. Competition will prove a powerful indicator at the time of renewal of contracts 	Annual
<ul style="list-style-type: none"> • External comparisons with other institutions 	As data becomes available
<ul style="list-style-type: none"> • Percentage of work undertaken by qualified and experienced personnel 	Annual
<ul style="list-style-type: none"> • Percentage of staff turnover rates 	Annual
<ul style="list-style-type: none"> • Number of training days per auditor 	Annual
<ul style="list-style-type: none"> • Planned and out-turn percentages of time employed on audit of systems within the annual plan 	Annual
<ul style="list-style-type: none"> • Actual time spent on individual audits against that planned* 	After each assignment and at a time of the annual report
<ul style="list-style-type: none"> • Actual versus planned expenditure 	After each assignment and at a time of the annual report

MEASURE/INDICATOR	TIMING
<ul style="list-style-type: none"> • Cost per direct audit day 	Annual
<ul style="list-style-type: none"> • Cost of audit as percentage of departmental expenditure 	Annual
<ul style="list-style-type: none"> • Progress against long-term plan 	After each assignment and at a time of the annual report
<ul style="list-style-type: none"> • Audit time as percentage of total time 	Annual
<i>Planning</i>	
<ul style="list-style-type: none"> • Observance of the Council's Code of Audit Practice in preparation and content of the audit needs assessment and strategic and annual audit plans 	Annual, at time of planning
<ul style="list-style-type: none"> • Submission of audit needs assessment and plans to the Audit Committee in time for agreement by the Governing Body in advance of the year to which they relate 	Annual, at time of planning
<i>Approach</i>	
<ul style="list-style-type: none"> • Observance of appropriate guidance on performance of assignments, especially in agreement of scope and timing of each assignment, identification of systems objectives and control objectives with management* 	After each assignment
<ul style="list-style-type: none"> • Management's perceptions of depth and impact of recommendations including systems weaknesses not identified by the audit* 	After each assignment
<ul style="list-style-type: none"> • Performance of follow up work within an agreed timescale following finalisation of assignment report 	Annual

MEASURE/INDICATOR	TIMING
<i>Reporting</i>	
<ul style="list-style-type: none"> • Completion of every assignment in the annual plan, subject to variations agreed by the Audit Committee, and if appropriate, the auditor 	At time of the annual report
<ul style="list-style-type: none"> • Fulfilment of the scope and objectives of each assignment in the annual plan* 	After each assignment
<ul style="list-style-type: none"> • Evaluation of all systems objectives and control objectives identified for each system reviewed* 	After each assignment
<ul style="list-style-type: none"> • Observance of Council guidance on assignment reports, especially the existence of a clear opinion on the adequacy and effectiveness of operation of control in each system audited in the assignment, an action plan of prioritised recommendations and management's response, person responsible and date for completion of action 	After each assignment
<ul style="list-style-type: none"> • Issue of draft and final reports within the period specified in the internal audit service's terms of reference 	After each assignment
<ul style="list-style-type: none"> • The number of findings or recommendations made by the internal audit service. Regard should be paid to the quality of findings, not simply the quantity. The subdivision of broad findings and recommendations and comment on trivial matters should be avoided. The condition of the system under audit will also influence the number of recommendations made** 	After each assignment

MEASURE/INDICATOR	TIMING
<ul style="list-style-type: none"> Percentage of recommendations implemented by management within a defined time period against those made 	Annual
<ul style="list-style-type: none"> The number of assignments completed, systems audited, or reports issued without regard for quality** 	Annual
<i>Relationships</i>	
<ul style="list-style-type: none"> Evidence of co-ordination between the internal audit service and the external auditor 	Annual
<ul style="list-style-type: none"> Attendance at Audit Committee 	Each audit committee meeting invited to
<i>Other</i>	
<ul style="list-style-type: none"> Customer satisfaction surveys 	After each assignment
<ul style="list-style-type: none"> Results of review of the work of the internal audit service by the external auditor if they intend to rely on it 	Annual
<ul style="list-style-type: none"> Results of the review of the work of the internal audit service by the Council's audit service 	As appropriate
<ul style="list-style-type: none"> Savings generated as a result of internal audit work. Apart from the realisation of such indicators being often difficult to prove, the generation of savings is not a principal objective of the core assurance provided by the internal audit service. Savings may be relevant where the internal audit service has been tasked with value-for-money reviews over and above the core assurance** 	Annual

** Measures/Indicators which might be evaluated through a written performance survey conducted by internal audit after each assignment, the result of which should be presented to the Audit Committee*

***Measures/Indicators which should be treated with particular caution.*

MODEL VERSION OF TERMS OF ENGAGEMENT FOR THE APPOINTMENT OF EXTERNAL AUDITORS

To the members of the Governing Body of.....

Engagement letter:

1. As appointed auditors of we agree to the following basis on which we shall perform our duties.

Appointment and Qualification

2. We understand that the Governing Body **will** consider annually the reappointment of the auditors. Remuneration **will** be fixed by the Governing Body on the advice of the Audit Committee.
3. We confirm that we are eligible for appointment as auditors in accordance with the meaning of the Companies Acts. We shall have right of access at all times to the books and records of the institution and to such information and explanations as we think necessary for the performance of our duties.

Responsibilities of the Institution

4. We recognise that the Governing Body is responsible on behalf of the institution for:
 - establishing and maintaining a system of controls, financial and otherwise, in order to carry on the operation of the institution in an orderly and efficient manner, ensuring adherence to management policies, safeguarding the assets, ensuring that funds have in all material respects been applied for the purposes for which they were given and securing, as far as possible, the completeness and accuracy of the records;
 - preparing financial statements that:
 - comply with the institution's Charters and Statutes, all statutory requirements relating to the institution's financial affairs, the Financial Memorandum (dated) with the Scottish Higher Education Funding Council (the Council), and other regulations relating to the constitution and activities of the institution and which are relevant to its financial affairs; and
 - show a true and fair view of the state of the institution's affairs at 31 July, recognised gains and losses and of the income and expenditure and cashflows for the year then ended, taking into account where relevant and appropriate all required statutory and other disclosure requirements and the Statement of Recommended Practice (SORP) on Accounting in Higher Education Institutions;

Standards of Audit

5. We **will** undertake the audit of the institution's financial statements and such other matters as the Governing Body requires in accordance with relevant Auditing Standards and Auditing Guidelines issued by the Auditing Practices Board.

Reporting

6. We as auditors are responsible for making a report to the Governing Body on the financial statements which are to be laid before the Governing Body during our tenure of office.
7. We understand that the Designated Officer of the institution **will** send copies of the audited financial statements to the Governing Body, to the Audit Committee and to the Financial Appraisal and Monitoring Service of the Council. We understand that, under the terms of the Financial Memorandum between the institution and the Council, the audited financial statements **must** be submitted to the Council within five months of the end of the institution's accounting period.
8. Our report **will** state whether in our opinion the financial statements show a true and fair view of the state of affairs of the institution [and the Group] at 31 July [], and of its [the Group's] income and expenditure and cash flows for the year then ended.
9. In arriving at our opinion we are required to consider the following matters and to report on any aspect of which we are not satisfied:
 - whether proper financial records are being kept by the institution;
 - whether the financial statements are in agreement with the accounting records;
 - whether the financial statements comply with the Statement of Recommended Practice on Accounting in Higher Education Institutions and other legislative and regulatory requirements [and whether they comply with the disclosure requirements of the Companies Acts¹] and;
 - whether we have obtained all the information and explanations we think are necessary for the purpose of our audit.
10. We **will** also report to the Governing Body whether, in all material respects, monies expended out of all non-recurrent grants and other funds from whatever source administered by the institution for specific purposes, have been properly applied to those purposes and, if appropriate, managed in compliance with any relevant legislation such as the Trustee Investment Act 1961.
11. We have agreed with the institution the wording of an unqualified audit report at the time of our appointment. Any subsequent modifications or necessary qualifications **will** then be based on our professional judgement, but **will** comply with the Statement

¹ to be inserted if the institution is a limited company

of Auditing Standard 600: Auditors' Report on Financial Statements and any additional requirements which may be made by the Council from time to time.

12. We undertake to report to the Governing Body by way of a Management Letter, within one month of issuing our opinion on the financial statements, any significant matters arising from the audit which might lead to material errors or have impact on future audits including:
- weaknesses in the structure of accounting systems and internal control;
 - where economies could be made or where resources could be used more effectively together with advice for improvement,
 - deficiencies in the operation of accounting systems and internal control, including internal audit;
 - inappropriate accounting policies and practices; and
 - non-compliance with legislation, the Statement of Recommended Practice on Accounting in Higher Education Institutions, other relevant accounting standards, the Council's requirements or other regulations.

We note that the institution **will** forward a copy of the Management Letter to the Council's Financial Appraisal and Monitoring Services.

13. We **will** report in writing any serious weaknesses, significant frauds or irregularities or any major accounting break-downs to the Designated Officer, the Chairman of the Governing Body, the Chairman of the Audit Committee and the Chief Executive of the Council without delay.

Irregularities, Including Fraud

14. Ensuring the establishment and maintenance of an adequate system of internal control is the responsibility of the Governing Body with whom rests the responsibility for ensuring compliance with statutory and other regulations, including those in relation to taxation, and for the prevention and detection of irregularities, including fraud. We are not required to search specifically for such matters and our audit should not therefore be relied on to disclose them. However, we shall plan and conduct our audit so that we have a reasonable expectation of detecting material mis-statements in the accounts resulting from improprieties, including fraud, or breach of regulations.

Additional Services

15. We may be asked from time to time to provide additional services beyond the scope of the audit described above. The precise requirements for any additional work **will** be agreed between the Governing Body and ourselves in a separate engagement letter before any work is undertaken. Any systems development or consultancy work **will** be the responsibility of staff other than those assigned to the audit.

Access

16. We shall have access at all times to the books and records of the institution and to such information and explanations as we think necessary to perform our duties.
17. We also expect to have access to the internal auditor's files and working papers. We, in turn, agree to comply with any requests from the internal audit service and the Council's Financial Appraisal and Monitoring Service, with the consent of the institution, for access to any relevant information files and working papers obtained or prepared during our audit that they need to discharge their responsibilities. Such access will be granted subject to an exchange of 'hold harmless' letters where required. We also expect to have access to the Chairman of the Audit Committee.

Attendance at Meetings

18. We will be entitled to attend the meeting of the institution's Governing Body or other appropriate body to which the institution's annual reports and financial statements of account are presented. We will also be entitled to receive all notices of, and other communications relating to any general meeting which any member of the Governing Body is entitled to receive, to attend any general meeting and to be heard at any such meeting, on any part of the business which concerns us as auditors. We reserve the right to request the Chairman of the Audit Committee to convene a meeting or a closed session of the Audit Committee.
19. We will attend Audit Committee meetings as required, the minimum requirement being attendance at those at which significant relevant matters are being considered.

Termination of Appointment

20. In the event of serious shortcomings on our part the Governing Body may, by resolution, remove us before the expiration of our term of office, without compensation, notwithstanding any agreement between us and the institution.

Fees

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

Agreement of Terms

22. If the contents of this letter are not in accordance with your understanding of the arrangements made, we shall be pleased to receive your observations and to give you any further information you require. Otherwise, we shall be grateful if you would confirm in writing your agreement to the terms of this letter by signing the enclosed copy and returning it to us. Once agreed, the terms of this letter will remain effective from one audit appointment to another until it is replaced.

Yours sincerely

On behalf of the Governing Body, I confirm that the above terms are satisfactory in respect of the external audit of [institution].

Signed

Position

Date

MODEL UNQUALIFIED EXTERNAL AUDIT REPORT

Auditors' Report to the [Court/Governing Body] of [Institution]

We have audited the financial statements on pages to which have been prepared under the historical cost convention [as modified by the revaluation of certain fixed assets] and the accounting policies set out on page

Respective Responsibilities of the [Court/Governing Body] and Auditors

As described on page, the [University Court/Governing Body] is responsible for ensuring that financial statements are prepared. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of our Opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the [Court/Governing Body] in the preparation of the financial statements, and of whether the accounting policies are appropriate to the [University's/College's] circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give us reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of the affairs of the institution [and the Group] at 31 July [], and of the [Group's] income and expenditure and cash flows for the year then ended and have been properly prepared in accordance with the Statement of Recommended Practice on Accounting in Higher Education Institutions [and relevant legislation of incorporation].
- funds from the Scottish Higher Education Funding Council, grants and income for specific purposes and from other restricted funds administered by the

institution have, in all material respects, been applied only for the purposes for which they were received;

- income has, in all material respects, been applied in accordance with the [relevant legislation of incorporation] and, where appropriate, with the Financial Memorandum dated [] with the Scottish Higher Education Funding Council.

(Name of Firm)
Chartered Accountants
Registered Auditors

Address
Date

HIGHER EDUCATION UK VALUE FOR MONEY INITIATIVE

Studies Completed at February 1999

Energy Management Study in the Higher Education Sector (February 1996)

The energy report takes into account and highlights examples of good practice of energy management as identified at the 21 institutions which participated in the study. The report offers advice on ways of reducing energy consumption and examples of savings made at pilot sites are included. In addition to the national report and the management review guide, institutions were provided with a computer disk containing software to enable institutions to assess the energy efficiency of individual buildings. The products of the study should assist institutions to become more environmentally friendly as well as to facilitate significant cost reductions.

Treasury Management Study in the Higher Education Sector (May 1996)

The treasury report identifies means by which institutions could achieve higher rates of return on their funds through improved cash flow and investment procedures. It takes account of and highlights examples of good practice which were identified at the 15 institutions which participated in the study. The report considers the strategy, procedures and activities necessary to manage the treasury management function effectively in an institution. To allow comparisons between institutions, the management review guide provides data collected from the pilot sites on areas such as bank charges and rates of return on short term cash investments.

Information Systems and Technology Management (September 1998)

The information systems and technology report highlights the issues for managers of IS/IT in higher education. It also gives cameos of good practice and recommendations for further action. The Management Review Guide is a practical working document, which managers can use to conduct a comprehensive review of the management of IS/IT in their own institution.

Building Repairs and Maintenance Study in the Higher Education Sector (June 1998)

The building maintenance report provides HEIs with an opportunity to enhance their current building maintenance arrangements and save costs. The recommendations emphasise an upward initiative as opposed to downward control by way of a checklist-driven approach. In addition, it will help institutions identify and implement complementary approaches where appropriate.

Studies In-Progress at February 1999

Three national studies are currently in progress and are due to be published later this year:

- Facilities Management;
- Management of Student Administration; and
- Management of Sickness Absence.

Further Information

Further information on National VFM studies and reports can be obtained from Brian Baverstock, Deputy Director of FAMS tel: 0131 313 6516 or e-mail: bbaverstock@shefc.ac.uk. Additional copies of the reports can be obtained from the Higher Education Funding Council for England. (A charge may be made for copies). The HEFCE address is: External Relations Department, HEFCE, Northavon House, Coldharbour Lane, Bristol, BS16 1QD. In addition, HEFCE has a VFM page on the World Wide Web: <http://www.hefce.ac.uk/initiatives/current/vfm>

NATIONAL AUDIT OFFICE HIGHER EDUCATION SECTOR VALUE FOR MONEY STUDIES

NAO VFM Studies in Higher Education

The NAO have also carried out a series of value for money studies in the higher education sector. These studies provide examples of good practice that institutions can adopt to improve their achievement of value for money in the use of resources.

Studies published at February 1999 are as follows:

The Management Of Building Projects At English Higher Education Institutions

Date published: 16 January 1998
HC 452, Parliamentary Session 1997/98
ISBN 010 283098 3

The Management Of Space In Higher Education Institutions In Wales

Date published: 28 June 1996
HC 458, Parliamentary Session 1995-96
ISBN 010 277996 1

The Management Of Teaching And Research Equipment In Scottish Higher Education Institutions

Date published: 19 June 1996
HC 432, Parliamentary Session 1995-96
ISBN 010 274996 5

Copies of NAO reports can be obtained from HMSO Bookshops.

FAMS's INSTITUTIONAL REVIEWS – OVERVIEW OF OBJECTIVES AND APPROACH

1. Review of Organisational Structure

Objectives:

- Assess whether the organisational structure is adequate to allow the Governing Body to be kept informed of audit and financial matters.

Approach:

- Review of Governing Body minutes
- Review of organisational structure
- Discussions with senior management

2. Review of Financial Management

Objectives:

- Obtain an overview of the budget setting process and effectiveness of budgetary control arrangements.
- Consider whether the quality and content of the financial information produced is appropriate to allow the actual performance of the institution to be monitored.
- Establish whether financial information is circulated to appropriate managers on a timely basis.
- Consider whether the finance function appears to be adequately resourced to perform at an adequate level.
- Consider key controls over main categories of expenditure.

Approach:

- Discussions with head of finance to ascertain the budgetary process, reporting process and key controls.
- Review of financial reports to budget holders, management and Finance Committee.
- Review of Finance Committee minutes.
- Meet with Chair of Finance Committee.

3. Review of Audit Committee Arrangements

Objectives:

- Assess whether the activities of the Audit Committee comply with the Code of Audit Practice and oversee the audit arrangements of the institution effectively.

Approach:

- Review of Audit Committee minutes.
- Meeting with Chair of Audit Committee

4. Review of External Audit Arrangements

Objectives:

- Assess whether the external audit arrangements are functioning effectively and comply with the Code of Audit Practice.

Approach:

- Review external audit management letters and other reports.
- Discuss with senior management.
- Meet with External Auditors.

5. Review of Internal Audit Arrangements.

Objectives:

- Assess whether the internal audit arrangements are functioning effectively and comply with the Code of Audit Practice.

Approach:

- Review planning documentation including the audit needs assessment, the strategic plan and the annual plan.
- Review a sample of internal audit reports and the annual report to the audit committee.
- Discuss with senior management.
- Meet with internal auditors.

6. Review compliance with good practice and related guidance

Objectives:

- Assess the adequacy of internal arrangements for the dissemination , implementation and compliance with good practice and related guidance.

Approach:

- Establish internal procedures for dissemination, implementation and compliance.
- Assess the effectiveness and operation of these procedures.
- Assess the overall level of compliance with good practice and related guidance.

INFORMATION REQUIRED FOR FAMS INSTITUTIONAL REVIEW SITE VISITS

(Please note that this list is not intended to be exhaustive)

General

- Minutes of Court/Governing Body
- Minutes of Finance Committee

Audit Committee

- Minutes of all meetings since FAMS last site visit
- Copy of external auditors' Management Letter (if not already sent to FAMS)
- Copy of most recent annual report (if not already sent to FAMS)

Internal Audit

- Copy of all reports since last FAMS site visit
- Copy of all annual reports since FAMS last site visit
- Audit Needs Assessment and Strategic Audit Plan
- Annual Audit Planning Statement (as contained in the institution's strategic audit plan)

NATIONAL AUDIT OFFICE REPORTS CONCERNING THE HIGHER EDUCATION SECTOR

Reports published between 1993 and May 1998

- **Investigation of Misconduct at Glasgow Caledonian University**

Published April 1998 (HC 680 Session 1997-98)

This report has not been the subject of a Committee of Public Accounts hearing. Consequently there is no Committee of Public Account's Report or Treasury Minute.

- **The Management of Building Projects at English Higher Education Institutions**

Published January 1998 (HC 452 Session 1997-98)

Committee of Public Accounts Report and Treasury Minute are not yet available.

- **University of Portsmouth**

Published May 1997 (HC 4 Session 1997-98)

This report was not the subject of a Committee of Public Accounts hearing. Consequently there is no Committee of Public Account's Report or Treasury Minute.

- **Governance and Management of Overseas Courses at the Swansea Institute of Higher Education**

Published January 1997 (HC 222 Session 1996-97)

Committee of Public Accounts – Eighth Report Session 1997-98

Treasury Minute-Government's response to the Committee of Public Accounts recommendations (Cm 3894)

- **The Management of Teaching and Research Equipment in Scottish Higher Education Institutions**

Published June 1996 (HC 432 Session 1995-96)

This report was not the subject of a Committee of Public Accounts hearing. Consequently there is no Committee of Public Account's Report or Treasury Minute.

- **The Management of Space in Higher Education Institutions in Wales**

Published June 1996 (HC 458 Session 1995-96)

Committee of Public Accounts-Twenty-First Report Session 1996-97

Treasury Minute-Government's response to Committee for Public Accounts recommendations (Cm 3714)

- **The Operations of the Student Loans Company Limited**

Published November 1995 (HC 13 Session 1995-96)

Committee of Public Accounts – Thirteenth Report Session 1995-96

Treasury Minute-Government's response to Committee of Public Accounts recommendations (Cm 3279)

- **Severance Payments to Senior Staff in the Publicly Funded Education Sector**

Published February 1995 (HC 202 Session 1994-95)

Committee of Public Accounts-Twenty-Eighth Report Session 1994-95
Treasury Minute-Government's response to Committee for Public Accounts
recommendations (cm 3013)

- **The Financial Health of Higher Education Institutions in England**

Published December 1994 (HC 13 session 1994-95)

Committee of Public Accounts – Twenty-First Report Session 1994-95

Treasury Minute-Government's response to Committee Public Accounts recommendations
(cm 2990)

- **University Purchasing in England**

Published May 1993 (HC 635 session 1994-95)

Committee of Public Accounts – Fifteenth Report, Session 1993-94

Treasury Minute-Government's response to Committee of Public Accounts recommendations
(Cm 2577)

Other published guidance

- **Equipment Management: Checklists for Good Practice** published June 1996
- **Space Management in Higher Education: A Good Practice** published June 1996

Published reports may be purchased through **The Stationery Office Limited**. Contact:

The Publication Centre (mail telephone and fax orders only) PO Box 276, LONDON SW8
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Fax orders-0171 873-8200

Further information about the **National Audit Office**, its organisation and audit methods is
available on request from:

The Information Centre
National Audit Office
157-197 Buckingham Palace Road
Victoria
LONDON
SW1W 9SP
Internet: nao@gtnet.gov.uk
Tel: 0171 798-7264
Fax: 0171 828-3774

FURTHER READING

TITLE	Published By
The Government Internal Audit Manual	H M Treasury (1996)
A Handbook for Audit Committee Members in Further and Higher Education	The Chartered Institute of Public Finance and Accountancy (1996)
Audit Committees - A Framework for Assessment	The Institute of Chartered Accountants in England and Wales (Audit Faculty) (May 1997)
Regularity and Propriety: A Handbook	HM Treasury (July 1997)

DEFINITIONS

For the purpose of this Code:

‘Act’ means the Further and Higher Education (Scotland) Act 1992;

‘BUFDG’ means British Universities Finance Directors’ Group

‘CIPFA’ means Chartered Institute of Public Finance and Accountability;

‘Code’ means the Scottish Higher Education Funding Council’s Code of Audit Practice;

‘COSHEP’ means the Committee of Scottish Higher Education Principals;

‘Council’ means the Scottish Higher Education Funding Council;

‘CVCP’ means the Committee of Vice-Chancellors and Principals of the Universities of the United Kingdom;

‘Designated Officer’ means the holder of the principal office of the institution designated by the Governing Body of the institution for the purpose of satisfying the Governing Body that funds from the Council are used only in accordance with the Act, the Financial Memorandum between the Council and the Institution and other conditions which the Council may prescribe;

‘FAMS’ means the Council’s Financial Appraisal and Monitoring Service;

‘Finance Committee’ means Finance Committee or equivalent committee established to oversee the financial affairs of the institution;

‘Finance Officer’ means the head of the finance function, (usually the Director of Finance);

‘Governing Body’ means the governing body which has ultimate responsibility for the management and administration of the affairs of the institution, (e.g. a University Court);

‘Head of IAS’ means the Head of Internal Audit Service of an institution or such person responsible for managing the provision of the internal audit service if contracted out;

‘ICAEW’ means Institute of Chartered Accountants for England and Wales

‘Institution’ means one of the higher education institutions in receipt of Council funds;

‘IAS’ means the institution’s Internal Audit Service;

‘NAO’ means the National Audit Office;

‘Performance indicator’ means an indirect measure of the extent to which economy, efficiency and effectiveness, quality and service levels have been achieved in an activity or function. Performance indicators tend to be used where direct measures are not readily available;

‘Performance measure’ means a directly quantifiable means of assessing the extent to which economy, efficiency and effectiveness, quality and service levels in an activity or function have been achieved;

‘SCOP’ means Standing Conference of Principals

‘SEELLD’ means the Scottish Executive Enterprise and Lifelong Learning Department.