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Further Education College Clerk Development and Training Programme Resource Pack

Module 12
The Audit Committee

For suggestions on how to get the most out of these self-study materials, see the booklet on 'Using the Materials'.

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Contents

Introduction

This module looks at the governing body's responsibilities regarding the audit process. It explains the important role the audit committee plays in providing independent assurance in respect of the college's financial position and the soundness of its internal control systems. As clerk, it will help you understand the role of the audit committee and how you can support governors.

Aims

By the end of this module you should be able to:

- explain why the governing body has an audit committee and what its purpose is;
- outline the terms of reference of your own audit committee and understand the considerations for maintaining independence;
- understand and use risk management models;
- explain the skillsets required to form a balanced and effective audit committee;
- understand the types of audit that the college is required to undertake, who should conduct them and their purpose;
- appoint, monitor and performance manage the auditors;
- understand and be able to explain to a non-audit committee governor the contents of the audit reports and the audit committee's annual report;
- have a clear understanding of the governing body's responsibilities with regard to fraud and irregularity.

Contents

Mark the sections you want to study and tick them off as you complete them.

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Working on the self-study activities

These materials have been designed to be used flexibly (e.g. dip in and out for reference; complete in one sitting; work through alone or with others).

Where you need to make notes in response to activity questions, we suggest you do this in a notebook or on separate sheets of loose-leaf paper, and store the information you compile along with the module for future reference. References listed in the Further Reading section may also be helpful.

What will you need

To complete the activities in this module you will need to get hold of the following documents:

- the most recent report of the external auditors and any recommendations made;
- the most recent report of the internal auditors or, in the case that internal auditors are no longer appointed, the report which demonstrates how the internal systems for financial control have been conducted;
- a copy of the most recent Joint Audit Code of Practice;
- a copy of the audit committee's annual report to the governing body including recommendations made.

Section 1. The purpose of the audit committee

The governing body of every college has statutory responsibilities, as stipulated under Part 2 of Schedule 4 of the Further and Higher Education act 1992 (as amended by the Education Act 2011), which cannot be altered under the general powers that corporations have had since 2011 to alter their Instrument and Articles of Government. These responsibilities are to ensure:

- the effective and efficient use of resources;
- the solvency of the college; and
- the safeguarding of the college's assets.

Under the Education Act 2011, colleges are permitted to make certain changes to their Instrument and Articles, though any such changes are subject to the limitations set out in this Act, any provisions contained within the Joint Audit Code of Practice – Part 2 (JACOP) and the contents of the funding body's financial memorandum.

In fulfilling these responsibilities, the governing body must:

- appoint an audit committee;
- appoint external auditors (also known as 'financial statements auditors'); and
- ensure that the organisation has sound internal control systems in place and that they are being adequately adhered to.

It is worth noting that the JACOP has effectively removed the requirement to appoint an internal audit service, which allows greater freedom for the audit committee to fulfil its responsibilities and obligations. The audit committee has a number of responsibilities, but its main purposes are to advise the governing body on the effectiveness of the college's audit arrangements and systems of internal control.

'Internal controls' are those controls that the college has put in place to minimise the risk of fraud taking place, to optimise value for money and to provide adequate safeguarding of the college's assets. The following are some examples of how these can be achieved:

- the regular and independent reconciliation of petty cash floats to ensure no money has been misappropriated;
- procurement policies that include a requirement for obtaining a minimum of three separate quotes, to ensure that purchases above a certain level of expenditure deliver value for money;
- conducting physical verification checks of college assets to ensure they have not been lost, stolen or damaged.

The audit committee has a key role to play in the overall governance of the college's activities. Much, if not all, of the information being reported to the governing body and its other sub-committees will be from the officers of the college and, as such, does not come from a truly independent source. The audit committee must ensure that the information being reported to the governing body is accurate and reliable, thus fulfilling a robust and challenging scrutiny role.

The principal is the college's chief accounting officer and has the responsibility to ensure that the framework of internal control that has been approved by the governing body is operating effectively. The audit committee can also be a mechanism for providing the principal with additional assurances that those controls are operating effectively, through the work of the auditors. Whilst the principal cannot delegate responsibility as chief accounting officer, it is normal practice for the principal to delegate the operational side of this role to a strategic-level finance officer (e.g. finance director), who will usually be a fully qualified accountant. This is covered in more detail in Module 10: Finance. It should be noted that the internal audit process can also cover the effectiveness of the governing body, specifically with regard to its annual self-assessment.

In summary, the audit committee provides the following benefits:

- it provides a level of assurance to the governing body that the college is effectively and efficiently using its resources, is solvent, and is adequately safeguarding its assets;
- it provides the governing body and the principal with additional assurances through a process of objective review of independent sources of information;
- it promotes the need for sound internal control and ensures the adequate implementation of any audit recommendations;
- it provides a route for a 'whistle-blower' or an auditor to raise any significant issues directly to members of the governing body; and
- it provides a forum to deal with any fraud or irregularities that arise.

Activity

What are the key benefits of having an audit committee?

Identify the two key benefits that your audit committee should provide to your college.

Viewpoint

The individual circumstances of your college may lead to a varying experience of the work of the audit committee. For example, a college that is experiencing financial difficulties may require this subject to be brought to the attention of all governors, and the agenda of governing body meetings may be dominated by this topic, sometimes to the detriment of other matters of college business.

In addition to the statutory responsibilities, it is important to regard the audit committee members' access to independent information from third parties as providing a unique position over other governors, who rely more on information coming from college officers.

Section 2. The function of the audit committee

The audit committee has a number of specific areas of responsibility, and these should be included in its terms of reference. The JACOP provides a 'minimum terms of reference', but refers to a suite of other guidance that is publicly accessible. The JACOP suggests that the following are included in the terms of reference.

The audit committee:

- must have the authority to investigate any activity it deems necessary;
- must have the right of access to obtain all the information and explanations it considers necessary, from whatever source, to fulfil its remit;
- must comprise at least three members, a majority of whom must be governors, but must not include the chair of the corporation or the principal;
- must ensure that it maintains its independence when considering the appointment of members;
- must have the range of skills and recent experience relevant to risk, governance, finance, audit, assurance and control; and
- must not be required to adopt an executive role.

The audit committee should meet at least three times a year and the timing of these meetings should coincide with the key financial and operational dates, such as dates appropriate to receive the reports and findings of the college's auditors.

In addition to the items identified by the JACOP as being appropriate for the audit committee's terms of reference, the audit committee will also have a number of other operational responsibilities:

- to advise the governing body on the appointment, re-appointment, dismissal and remuneration of the college's auditors;
- to ensure co-operation between auditors, including ensuring complementary schemes of audit work, where different firms are being used for internal and external audit work;
- to be responsible for the production of an annual audit plan, which will be ideally based upon the college's risk register;
- to consider reports from auditors and other external consultants engaged by the committee, agree management responses and monitor that agreed recommendations have been actioned;
- to review the annual management letter from the external auditors, following completion of their audit work;
- to monitor the effectiveness of auditors;
- to consider any audit reports received from the funding bodies; and
- to produce an annual report for the governing body containing information on the adequacy and effectiveness of the college's systems of internal control, use of resources and safeguarding of assets.

Activity

Review your audit committee's skillsets against those suggested by the JACOP, as below:

- risk;
- governance;
- finance;
- audit;
- assurance; and
- internal control.

Identify any areas of weakness, or skills gaps and explore with the audit committee if there is a need to appoint or 'co-opt' additional membership.

Section 3. Risk management

There are a number of models that are widely used to measure and manage risk and there is clearly no 'right' or 'wrong' method to adopt. This guidance offers one such model as a suggested methodology, but you will need to identify the one that best fits the needs of your organisation.

The role of the audit committee is pivotal in ensuring that the college is properly engaging in the process of managing its risks.

What is risk management?

"Risk management covers all the processes involved in identifying, assessing and judging risks, assigning ownership, taking actions to mitigate or anticipate them, and monitoring and reviewing progress. Good risk management helps reduce hazard, and builds confidence to innovate."
HM Treasury 'The Orange Book'

There are a number of areas of risk that a college needs to be mindful of and below is a suggested checklist, based upon the above HM Treasury definition, to help you support your college's risk management.

Identify

A key element of the discussion, when making decisions at any level of any organisation, is to identify the risks associated with those decisions. The college has a number of key documents that will need a thorough risk assessment, including the development of the strategic plan, the annual business plan, the financial plan, the self-assessment report and associated quality improvement plan, to name but a few.

Assess impact and probability

This can be done through any number of models, usually based on impact and probability. The impact should not be purely focused on the financial impact, but should also take account of the potential effect on the achievement of all of the college's strategic objectives. The below model is one such approach, with the higher scores determining the higher risks and probabilities:

- Financial Impact Assessment (F) (Score 1-3)
- Reputational Impact Assessment (R) (Score 1-3)
- Judgement of Probability (P) (Score 1-3)

$$(F + R) \times P = \text{Risk Score}$$

The scoring is then categorised as follows:

- 12-18 = High Risk
- 6-11 = Medium Risk
- 0-5 = Low Risk

Assign ownership

Only the high risks would normally then be identified as being the 'key' ones. For a more risk-averse college, the medium risks could also be treated as 'key'. It is important that the governing body, perhaps through the audit committee, sets the tone for the college's appetite for risk.

The responsibility for each 'key' risk should then be assigned to the most appropriate person within the organisation, which will normally be a college officer, rather than a governor.

Decide appropriate action

For each 'key' risk identified above, an action plan should be identified. These can be categorised and are sometimes referred to as the '4 Ts':

Treat:	put in place an action plan to reduce the probability or the impact of the identified risk.
Transfer:	take action to transfer the risk somewhere else.
Terminate:	in the event that the risk is deemed to be 'not worth taking', remove the risk altogether by not taking this course of action.
Tolerate:	accept that this level of risk is appropriate for the risk appetite of the college and take no action.

Monitor

The impact of the risk management actions should be monitored. It can be helpful to 're-score' the risk post-action. E.g. the risk has been 'treated', which has reduced the probability score from '3' to a '2'.

Review

The college should undertake a regular review of the key risks facing it and the appropriateness of the actions being taken to mitigate the risks. The college may wish to assign this task to an internal team to undertake and report back to the audit committee for independent scrutiny.

Risks being faced by colleges may come from external factors such as Government policy, funding body cuts and the general state of the economy. Other factors may include the college's ability to recruit and retain quality staff, the reliability of the IT infrastructure, and competition from other providers. It is important that the identification of risk is specific to the college and is regularly reviewed to ensure currency.

The definition provided at the beginning of this section identified all the key components, but perhaps the one that most appropriately captures the essence of a positive and engaging attitude to risk management is that it can actually be an aid to innovation, rather than stifling it.

Activity

Identify two of the key risks facing your college. Go through the risk management process identified above for both of your chosen risks to satisfy yourself that the risks are being adequately managed.

Is risk management a specific item on the audit committee agenda or identified within the cycle of meetings? Are you confident that your governing body is sufficiently informed on matters of risk management?

Viewpoint

Risk management is not an exact science. Neither the identification of the risks nor the methodology of scoring the probability and impact of those risks can be necessarily deemed either ‘right’ or ‘wrong’.

The audit committee should satisfy itself that the senior management team is adequately managing the college’s risks by ensuring that it receives regular reports and that these are independently scrutinised.

Many organisations have information contained in other documents, such as a ‘Disaster Recovery Plan’ or a ‘Business Continuity Plan’, which set out how the college would manage in the event of mass-IT failure, terrorism or natural disasters. It is worth familiarising yourself with these documents.

One of the key mitigations is the use of insurance cover to ‘transfer’ the risks – it is also worth ensuring that key risks are adequately covered by your college’s insurance policy, if this is the identified method of risk management.

Section 4. Audit committee membership

As identified previously, the JACOP states that the audit committee must have at least three members and, while the members do not need to be qualified accountants, they do need to have sufficient skills and experience between them to adequately meet the terms of reference of the committee.

The members of the committee do not all need to be governors, as the membership can include co-opted members to meet the full range of skills, knowledge and experience required, but it is not recommended that the chair of the audit committee should be a co-opted member, given that the chair is required to report back to the full governing body.

A suitable mix of skills, knowledge and expertise could include the following:

- a good understanding of the role of auditors;
- a good working knowledge of some aspects of law;
- procurement experience;
- risk management; and
- a background in education.

A key attribute for members of the audit committee is the willingness to challenge and seek clarification. This does not require a background in audit or finance and, in fact, it could be argued that a member of the committee with a general business background is as important, to be able to provide the necessary 'supply-side' scrutiny.

The committee members must be independent of college management, which means they should not be staff governors (including the principal). The committee members should also not form part of other committees, and should not include the chair of the governing body. The audit committee members will need to maintain independence to ensure the impartiality of any investigation into a decision made by another committee, should the need arise.

It is, however, appropriate for the relevant members of college management to attend audit committee meetings to offer context and explanation, as required. This applies equally to the clerk to the audit committee, who should not jointly hold a position in the college with significant financial or strategic responsibility.

The audit committee should undertake an annual self-assessment exercise, dealing with the following key themes:

- skills audit: has the committee had the full range of knowledge and expertise required to exercise its duties during the year?
- terms of reference: are the current terms of reference appropriate for the prevailing needs of the governing body and has the committee met these terms of reference during the past year?
- coverage: have the audit committee agendas covered everything that has been deemed necessary by the members?

Activity

Review the membership of your audit committee. Do you believe that the members represent the fullest possible range of required skills, knowledge and experience? Conduct a matching exercise against the above list and identify a solution for meeting any perceived gaps.

Viewpoint

An effective audit committee is not solely about what is on the members' CVs. A strong personality, an appropriate level of self-confidence and a willingness to ask the challenging questions can sometimes be at least as important as having the more technical audit-related knowledge.

A balance of all of the above will ensure that your audit committee has everything needed to discharge its duties effectively and add genuine value to the college's corporate governance.

Governors should always ensure that the college provides an appropriate level of budget to enable members to procure training and other support to close any skills gaps that have been identified by the audit committee self-assessment process.

Independence is critical and it is important that all governors have the ability to raise any concerns through the proper channels, either via the clerk, or directly to the chair of the governing body.

Section 5. Types of audit

The JACOP identifies different types of audit and it is important to understand the differences.

Financial Statements Audit (also referred to as 'External Audit')

The funding body's financial memorandum stipulates the requirement for a college governing body to appoint external auditors to conduct an audit of the financial statements each financial year. The criteria for eligibility as financial statements' auditor must be the same as set out in Part 42 of the Companies Act 2006:

- A firm or individual holding membership of a relevant supervisory body (the Consultative Committee of Accounting Bodies (CCAB) member organisations) and allowed to carry out audits under the rules of that body.

The governing body must be the appointing authority for the financial statements auditor.

The responsibility of a college's financial statements auditor is to audit the financial statements in accordance with the relevant legal and regulatory requirements. This includes the International Standards on Auditing (ISAs). In doing so, the financial statements auditor must provide an opinion on whether the financial statements, in all material respects, give a 'true and fair view'. The Statement of Recommended Practice: Accounting for Further and Higher Education and the relevant year's Accounts Direction determine most of the style and content of the financial statements.

The funding body should inform the auditor of the amount of funding to be included in the financial statements and the financial statements auditor is not required to audit the underlying funding claim in order to form their 'true and fair view'. The accuracy of the funding claim remains the responsibility of the governing body and college management and the funding body may choose to audit the claim.

This is similar in many ways to the audits conducted on the financial statements of a commercial organisation and, for those governors with a commercial background, this may be familiar.

The financial statements auditors should issue a management letter upon the conclusion of the audit. This letter should set out any key findings, any weaknesses in the system of internal control that were identified during the audit, and a comment on the truth and fairness of the financial statements. If the auditors are unable to satisfy themselves on a particular aspect of the financial statements, they may issue a 'qualified' audit opinion.

Regularity Audit

It is a specific requirement that colleges use their funding body income with 'regularity' and 'propriety'. These are defined, by HM Treasury, as follows:

Regularity

"The requirement for all items of expenditure and receipts to be dealt with in accordance with the legislation authorising them and any applicable delegated authority and the rules of Government Accounting"

For colleges, this includes meeting the requirements of the Further and Higher Education Act 1992 with amendments, as well as the funding body's financial memorandum.

Propriety

"The requirement that expenditure and receipts be dealt with in accordance with Parliament's intentions and the principles of Parliamentary control, including the conventions agreed with Parliament (and in particular the Public Accounts Committee(PAC))."

For colleges, this basically means that the college should be able to justify that any expenditure is a 'proper' use of public funds and is appropriate for the running of a college.

The role of the regularity auditor is, therefore, to provide an opinion over the 'regularity' and 'propriety' of all college expenditure, regardless of the source of the funds.

Internal Audit

Internal audit is an independent audit service that carries out evaluations of internal financial and other controls. As mentioned earlier, the college governing body has the responsibility for the effective and efficient use of resources, the solvency of the institution and the safeguarding of the assets.

The use of internal auditors is one methodology that the audit committee may choose to take in order to discharge their responsibilities in this regard. The internal auditor should work with the audit committee and college management to identify a programme of work for the coming year, based upon the college's perceived risk profile, which will form the content of the annual audit plan. The internal auditors will then issue an audit report at the end of each block of activity, to include a summary of findings, recommendations for improvement and a report on the follow-up of any previous recommendations to ensure appropriate actions have been taken. The risks of non-compliance are usually identified by the auditors by identifying them as low, medium and high risk.

However, the appointment of an independent internal audit service is mandatory neither under the Articles of Government nor under the funding body's financial memorandum. The audit committee now has increased freedom and flexibility to determine the best methodology for providing the governing body with the requisite assurances.

The internal auditors will examine the college's risk register, use their own skills and knowledge as well as calling upon their recent experience from other colleges to conduct a needs assessment that results in the production of the internal audit plan. This plan will be presented to the audit committee and the committee can agree amendments at this stage before final approval by the governing body. College management should be consulted in the production of this plan, but should not be allowed to exert too much influence to avoid any potential conflicts of interest.

Funding Body Audit

The funding body may choose periodically to examine the accuracy of the student data as well as the adequacy of the supporting documentation that a college holds to substantiate the funding claim that forms part of the college's financial statements.

This does not form part of the audit committee's remit to instigate, but clearly any findings should be reported back to the committee for scrutiny. The audit committee should satisfy itself that the college is adequately prepared for this type of audit and, through the checks on internal controls, should establish a cycle of student record validations. These audits use standard sampling techniques and any systematic errors identified can result in substantial funding claw-backs.

Activity

Review your most recent internal audit report or equivalent. The report should contain a series of recommendations and management responses.

- Check that the work covered meets with your expectations and is line with the agreed annual audit plan.
- Ensure you are satisfied that the recommendations from the auditors are reasonable and appropriate for implementation.
- Check that you agree with the management responses and concur with their proposed actions and time-frames.
- Identify any audit recommendations that carry a 'high-risk' rating and ensure that the proposed actions go far enough and are to be completed soon enough.
- Check through the follow-ups from the previous audit work and ensure that management have done everything that they said they would, or offered satisfactory explanations if not.

Viewpoint

The use of auditors and other external expertise is one of the most critical elements of effective governance.

Given the obvious potential for conflicts of interest between college management's responsibilities for running an effective and efficient college, whilst also often being the governors' only source of information on how effective and efficient the college is, the power of auditors as a truly independent source of information is clear.

While it is not compulsory for college management to agree to all audit recommendations, it is important that they offer a satisfactory explanation as to why the recommendation has not been agreed to. For example, where the college is particularly well-run in the areas that have been audited, the recommendations may all be fairly minor and against low-risk areas. On the other hand, where a recommendation from a previous report, that was perceived to be high-risk in nature, has not been implemented, the governing body needs to be made fully aware of the reasons why management have not taken the stipulated actions, in order for it to assess if this presents an unacceptable level of risk.

Audit reports can be lengthy documents and it is important for the clerk to be supporting governors in the co-ordination of the auditors and their reports, as well as the monitoring of progress against the recommendations.

Section 6. Selecting the auditors

There are a number of key elements that the governing body will need to consider when choosing the auditors. Clearly, one consideration is their independence from the college, its employees and its governors. It is possible that a governor may be the employee of an audit firm or a co-opted member of the audit committee may run a local firm of auditors, so independence checks are important.

Whilst most colleges use external firms of auditors for all audit work, it is permissible for organisations to employ their own internal auditors. In this eventuality, the audit committee will need to have direct access to this team and ensure that management is not able inappropriately to interfere in its operation and the content of its reports or influence its schedule of work.

The standing orders of the committee should ideally include information on the frequency of the re-appointment of auditors and there may also be the suggestion of a change of partner from time-to-time, if the same audit firm is re-appointed repeatedly, to ensure independence and a fresh perspective, but you will need to decide if this is a necessary or appropriate stipulation for your college. Even though there may be a four- or five-year cycle for the full selection process of auditors, both the internal (if used) and external auditors should be only be appointed on an annual basis for the coming year.

The audit committee is responsible for advising the governing body on the effectiveness of the auditors and may agree a set of Key Performance Indicators (KPIs) to measure them against each year. A possible set of KPIs may include:

- value for money;
- quality and perceptiveness of the audit plan;
- appropriateness of the skills, knowledge and experience of the audit team;
- timeliness and appropriateness of the audit reports and recommendations; and
- attendance at audit committee meetings

If the committee feels that the auditors are not meeting the required level of performance, they may recommend to the governing body that a change should be made, even if it falls within the originally agreed four- or five-year time period.

Similarly, the auditors themselves are able to withdraw their offer of services and, if they offer their resignation within the time period specified in the letter of engagement, can remove themselves before the specified contractual period has elapsed.

An auditor resigning from the college should be seen as a potential cause for concern and audit committee members should be aware of the particulars surrounding the resignation. Whilst there are many potentially innocent and acceptable explanations for an auditor resigning or being removed, there are equally some reasons that may present the governing body with increased risks, so you should ensure that these are adequately communicated, to enable the audit committee to advise the governing body as deemed necessary.

Activity

Are you aware of the required cycle of auditor re-appointment?

Have the auditors been working for the college for an extended period and do you feel that this presents a problem?

Does the audit committee regularly assess the effectiveness of the auditors and/or use KPIs?

Viewpoint

The purpose behind the use of auditors really comes down to the concept of providing independent scrutiny. You should, therefore, ensure that the auditors are operating truly independently of college management and additionally are able to get direct access to the audit committee, without consulting with college management, if they feel this is warranted. As clerk, you will be needed to facilitate these meetings.

It is important also to remember the human factor when considering the best way to achieve optimal independence. Some committee members may feel awkward about asking certain questions of auditors in front of college management and, indeed, you may get a more frank answer from auditors in the absence of college management.

Some audit committees insist on at least part of the meeting being conducted privately between the auditors and the committee members, without the presence of college employees. This ensures that the auditors are given a forum to speak openly on topics that may incriminate college management and adds to the perception that the audit committee is truly independent of college management.

However, this can be counter-productive, since college management will ultimately need to be given an opportunity to respond to whatever concerns have been raised and will usually be the ones implementing any resulting recommendations in any case. It could, therefore, be argued that being excluded from the meetings in the first place simply slows the process down and may equally create negative feelings.

There really is no right or wrong approach, so the governors will need to decide upon the most appropriate model for the college.

Continuity of auditor can also have its own pros and cons and, before getting overly focused on maintaining independence, it should not be under-estimated how much the college will benefit from having auditors with prior knowledge of the institution and its management, but, as with any business, audit firms will inevitably have turnover of staff, from partner-level to audit teams members.

Section 7. The audit committee annual report

The work of the audit committee is summarised every year by way of an annual report which is presented to the full governing body, usually at the last meeting of each annual cycle. This report effectively discharges the audit committee's responsibility for advising the governing body on the controls in place to ensure:

- the effective and efficient use of resources;
- the solvency of the college; and
- the safeguarding of the college's assets.

Below is a suggested checklist for the contents of the audit committee annual report:

- terms of reference;
- committee membership;
- summary of meetings and dates held;
- internal auditor summary, highlighting any high-risk recommendations;
- summary of the financial statements auditor's management letter, including regularity audit;
- risk management report; and
- summary of the adequacy of controls against the three main responsibilities highlighted above.

Activity

Review the most recent audit committee annual report

How thorough is the report and how well informed would a non-audit committee governor be on the adequacy of the controls in place?

Talk to the finance director and discuss what improvements, if any, should be made.

Viewpoint

The annual report is a key summary of the activities that the audit committee has had oversight of during the year and is the document that effectively discharges the committee's responsibility to inform the governing body of the adequacy of the financial and other controls that are in place.

It should be noted that many college governors come into this role driven by a passion or an interest in further education and meeting the needs of young people or their wider community, and may have little or no experience, or indeed understanding, of the work undertaken by the audit committee. As clerk, you will need to ensure governors are confident in this role.

This report needs to ensure that the often technical work that is undertaken by this committee is translated into clear language that can be understood by most, if not all, governors.

Section 8. Fraud and irregularity

The responsibility for protecting the organisation against fraud and irregularity lies with the governing body, which will usually look to the audit committee to provide the requisite assurances that they need to adequately discharge this responsibility.

The JACOP sets out the expectation that the financial statements auditor has a professional duty to plan and conduct the audit so that there is a reasonable expectation of detecting material misstatements in the accounts arising from irregularities, including fraud, or breaches of regulations. It is very clear, however, that the financial statements auditor does not have a duty to search specifically for irregularities or fraud, and their audit should not be relied upon to detect any or all that occur.

The JACOP also defines 'significant fraud' as meeting one or more of the following criteria:

- there is likely to be great public interest because of the nature of the fraud or the people involved;
- the sums of money are in excess of £10,000 (or £5,000 in the case of the 16 to 19 Bursary Fund); or
- the particulars of the fraud are novel or complex.

The JACOP states that all colleges have an obligation to have in place a written policy and procedures, agreed by the governing body, on the process to be followed when suspicion arises of a potential irregularity, including fraud, corruption, any impropriety or major weakness or breakdown in the accounting or other control framework. The JACOP also requires this policy to include a statement on the authority of the audit committee to commission a special investigation as deemed necessary in response to any irregularity identified or suspected.

If the chair of the audit committee deems it necessary to intervene with more urgency than waiting for the next governing body meeting would allow, they can do so, usually after consultation with the chair of governors. The chair of the audit committee needs to ensure that the policy and procedures are being properly followed and that appropriate action is being taken, and must then report the details at the next governing body meeting. Where the chair of the audit committee feels that they do not have the required time, knowledge or experience to adequately perform this duty, they may call upon external professional advisers to support them and college management should ensure that the necessary budget is made available to cover this cost.

College management will normally have taken action in the first instance and the policy should set out the required protocols for doing so. This should include a focus on the identification of the individual or group of individuals responsible for the irregularity, but also a focus on the identification of any alterations to processes and procedures that could help to reduce the risk of recurrence.

Activity

Reporting structures for fraud or irregularity

What procedures does your governing body have in place for handling the reporting of fraud or irregularity? Consider the following questions.

- Are you aware of the procedure for the reporting of possible fraud or irregularity?
- Do you feel that all governors are aware of this procedure?
- Does this procedure vary if the identifier is a member of staff, or a member of the public?
- Does this procedure vary if the perceived perpetrator is a member of staff or a governor?

Viewpoint

Irregularity may be the result of something deliberate, but it is also possible that it could be the result of human error. Policies and procedures ensure that things are done in an efficient and effective manner, but cannot provide any level of guarantee against mistakes.

The system of internal control should ensure that any sensible steps are taken to minimise the risk of irregularity and it is the responsibility of the governing body, mostly through the work overseen by the audit committee, to be satisfied that every reasonable measure is in place.

Below are some examples of operational level controls:

- the member of staff responsible for inputting an invoice into the purchase ledger should not be the same person who authorises it for payment;
- members of staff required to perform student eligibility checks should be given the requisite level of training to be able to perform this function; and
- sample-based checks of student eligibility are undertaken by a different member of staff to ensure consistency of compliance.

The auditors are not responsible for seeking out every fraud and mistake and the level of materiality set out by the JACOP is sensible at £10,000. A balance needs to be struck between the cost of the resource that would be required to identify every item of low-value irregularity and the benefit from the potential losses that could be saved as a result.

Again, it may not be appropriate or necessary for all governors to be fully aware of the college's procedures for reporting suspected irregularity, but it is vital that all members of the audit committee should be clear as to the contents of the procedure.

Section 9. Developing good practice

Now you have almost completed this module, you should be in a position to review the effectiveness of your college's audit committee. Given the key role of the audit committee in providing key assurances to enable the governing body to adequately discharge certain responsibilities, it is a valuable exercise for the committee to self-assess on an annual basis and appraise its effectiveness. The checklist below aims to support this process.

Activity

How effective is the audit committee?

Use the checklist below and answer 'yes' (Y) or 'no' (N) or 'further development needed' (D) to each question. If you are unsure about a particular question, you should refer back to the relevant section in this module. If you are unsure about your own audit committee's position, it may be helpful to discuss the matter with the chair of the governing body, the chair of the audit committee or the most senior finance officer. It may be useful for the audit committee to consider its response to these questions at one of its meetings to form a consensus view, rather than the individual views of members.

Good practice checklist

The audit committee	**Y,N or D**
Does the audit committee have written terms of reference which are approved by the governing body?	
Do the written terms of reference allow the audit committee to maintain its independence from the management of the college?	
Are the members of the audit committee separate from the management of the college to ensure their independence?	
Is there at least one member of the audit committee who has an appropriate finance and/or audit background?	
Does the audit committee meet at least three times per year?	
Is the timing of the audit committee meetings arranged so that key decisions and areas of advice can be fed into full governing body meetings?	
Does the audit committee carry out a self-assessment exercise on its own performance on an annual basis?	
Does the audit committee produce an annual report for the governing body advising them on the adequacy of the internal control systems operating at the organisation?	
Auditors	**Y,N or D**
Do all auditors have direct reporting access to the audit committee?	
Do all auditors attend at least one audit committee meeting annually?	
Does the audit committee review and recommend to the governing body for approval the annual audit plan?	
Do the auditors adequately resource the work with individuals who have the relevant skills and experience?	
Are audit reports produced promptly after fieldwork to allow enough time for management responses before the next audit committee meeting?	

Auditors	**Y,N or D**
Are internal audit reports written in a clear and understandable style; do they provide adequate levels of assessment of the controls in the area reviewed and practical recommendations for improvement in the identified areas of weakness?	
Do auditors plan their work so that they can follow up implementation of recommendations from previous reports after an appropriate period of time?	
Do the internal auditors produce an annual report for the audit committee that includes an overall assessment of the adequacy and effectiveness of operation of the organisation's internal control systems?	
Are the management letters from the auditors clearly laid out, identifying significant issues arising out of their audit work, with practical recommendations for improvements?	
Fraud and Irregularity	**Y,N or D**
Does the organisation have written procedures on the action to take if a case of suspected or known fraud or irregularity is reported?	
Is the audit committee satisfied that the auditors have planned and conducted their audit work so that they have a reasonable expectation of detecting material misstatements in the accounts resulting from irregularities, including fraud or corruption, or breach of regulations?	

Viewpoint

In a simplistic way, where you have answered 'yes', you have indicated that you are satisfied with this aspect of audit committee business, but the situation can change and you should be mindful of not completely removing focus on this area.

You should notify the chair of governors of areas where you have answered 'no' and you should consider identifying this as an agenda item at the next meeting, or discussing with the auditors to get their views.

Similarly, if you feel areas require further development, this should be raised by way of an agenda item at the next audit committee meeting.

Module review

This module has looked at the roles and responsibilities of the audit committee. You should now be able to:

- explain why the governing body has an audit committee and what its purpose is;
- outline the terms of reference of your own audit committee and understand the considerations for maintaining independence;
- understand and use risk management models;
- explain the skillsets required to form a balanced and effective audit committee;
- understand the types of audit that the college is required to undertake, who should conduct them and their purpose;
- appoint, monitor and performance manage the auditors;
- understand and be able to explain to a non-audit committee governor the contents of the audit reports and the audit committee's annual report;
- have a clear understanding of the governing body's responsibilities with regard to fraud and irregularity.

Summary of key learning points

- All colleges are required to have an audit committee which supports the governing body in discharging its duties for ensuring the effective and efficient use of resources, the solvency of the college and the safeguarding of the college's assets.
- The audit committee should have clearly defined terms of reference, which are approved by the governing body, and should ensure the optimal independence of the committee and its members.
- The audit committee should have a suitable mix of skills, knowledge and experience, including at least one member with relevant financial and/or audit experience.
- The audit committee is responsible for advising the governing body on the appointment, re-appointment, dismissal and remuneration of auditors through suitable performance management processes.
- The audit committee reviews the reports and recommendations made by the auditors and ensures the adequate intervention by college officers.
- The chair of the audit committee would normally set up an investigation into an allegation of fraud or irregularity and advise the governing body of the outcome and make recommendations on the appropriate action that should be taken.

Where next?

You have now completed work on Module 12: The Audit Committee. If there are areas in which you need more guidance or information, they may be covered in other modules. Turn to 'Check your current knowledge and skills' in 'Using the Materials'. This self-assessment questionnaire will help you to decide which modules or sections of modules may help to fill these gaps. Tick the useful sections for further study.

If you cannot find the information you need within these materials, turn to the 'Action Planner' in 'Using the Materials'. Note down what further information, support or guidance you would like. The 'Action Planner' gives advice on who may be able to help. Follow up the web links in the modules to support your general knowledge of relevant FE issues.

Putting it into action

We hope that working through this module has raised useful questions, increased your knowledge and awareness of issues and given you ideas for practical action that you would like to follow up. The ‘Action Planner’ contains a section where you can note down any questions or action points that you want to follow up within your own college.

Further reading

Joint Audit Code of Practice Part 2 including further reading recommendations

The Orange Book - Management of Risk – Principles and Concepts HM Treasury 2004

The Audit Commission - standing guidance, which sets out auditors' statutory terms of appointment and specifies the Commission's regulatory requirements.

The Institute of Internal Auditors – guidance topics.

ACCA – the global body for professional accountants.

Institute of Chartered Accountants

Public Sector Internal Audit Standards: good practice guidance

Acknowledgements

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