

**To: Heads of higher education
institutions in Wales**

REFERENCE: W00/77HE

DATE: 23 March 2006

FURTHER

INFORMATION: Rob Rogers/Claire Bushell

Welsh Funding Councils' Audit Service Guidance (WFCAS) – AUDIT OF FUNDS FOR THE PURPOSE

During the past year, the reviews performed by the WFCAS have revealed a number of instances in which we believe that insufficient work has been performed by external auditors as the basis for their opinion in institutions' financial statements on 'funds for the purpose', that is verifying that funds received have been properly applied for the purpose provided and in accordance with the financial memoranda between the Funding Councils and institutions.

The WFCAS report attached as an annex to the National Audit Office (NAO) report on 'Financial Management and Governance at Gwent Tertiary College' stated that the external auditors did not undertake any detailed testing or expenditure to primary records to support their audit opinion that funds have been used for the purpose provided. It also stated that detailed testing of the application of the College's income from the European Union would have highlighted the problems in this area of the College's operation.

Therefore, to ensure consistency of approach and promote clearer understanding, the Higher Education Funding Council for Wales (HEFCW) has developed guidance on the audit of 'funds for the purpose' to take effect for the audit of financial statements for the year ended 31 July 2000.

The guidance has been prepared following consultation with a sector working group and with external audit providers.

The guidance aims to provide institutions and their external auditors with direction on the HEFCW's expectations of the work to be undertaken to confirm that funds received by institutions have been used. For this purpose, the guidance will also be supplemented by an annual circular which will provide details and amounts of specific funding that have been provided to an institution by the HEFCW during each financial year.

The guidance should be made available to external auditors, audit committees, senior management and internal auditors. A copy should be placed on the HEFCW Audit Code of Practice control file in Section 4 on Audit Related Letters, reference ARL/HE/5.

In the meantime, if you have any queries or require further information please contact Rob Rogers on 029 2068 2201 or Claire Bushell on 029 2068 2276.

Enc: 3 copies of the Audit of Funds for the Purpose Guidance

Copies to: Chair of Governing Body
Clerk to the Governing Body

INTRODUCTION

- 1 Institutions are responsible for ensuring that funds from the Higher Education Funding Council for Wales (HEFCW) are used only in accordance with the Further and Higher Education Act 1992 (the Act), their Financial Memorandum with the HEFCW and any other conditions which the HEFCW may from time to time prescribe. Institutions must ensure that they have in place appropriate financial and management controls sufficient to safeguard public funds and ensure that they are only used in accordance with the conditions under which they have been made available.
- 2 The Audit Code of Practice states that the primary role of external audit is to report on the financial statements of institutions and to carry out such an examination of the financial statements and underlying records and control systems as is necessary to form an opinion on the financial statements. However, the audit of public funds is different from audit in the commercial sector in that auditors must also provide an opinion on whether funding received from the HEFCW and other bodies, and other restricted funds where appropriate, have been properly applied for the purpose provided ('funds for the purpose') and in accordance with the Financial Memorandum between the HEFCW and institutions.

BACKGROUND

- 3 The aim of this guidance is to provide institutions and their external auditors with direction on the HEFCW's expectations of the work to be undertaken to confirm that funds received by institutions have been used for the purposes provided. The guidance is not intended to be exhaustive and the responsibility remains with the external auditor to ensure that they carry out appropriate and sufficient audit work to support their opinion in the financial statements. It is recognised however that it is for external auditors to use their own professional judgement as to the precise audit work that is required.
- 4 The WFCAS will continue to review the work performed by external auditors on 'funds for the purpose' as part of their institutional reviews.
- 5 This guidance will be supplemented by an annual circular which will provide details and amounts of specific funding that have been received by an institution during the financial year.

AUDIT APPROACH

- 6 As the external auditor is required to give an opinion on 'funds for the purpose', it is considered appropriate for the auditor to make a separate assessment of materiality specifically for such funds. *Statement of Auditing Standards 220 states that materiality may be influenced by considerations*

such as legal and regulatory requirements, which may result in different materiality considerations being applied to particular aspects of the financial statements. Auditors will need to ensure materiality levels are consistent with the risk environment of a particular audit.

7 The audit of 'funds for the purpose' should be carried out in accordance with relevant auditing standards specifically covering planning, controlling and auditing, accounting systems and internal controls, evidence and using the work of others. This will include:

- a) planning the work, obtaining and documenting an understanding of the accounting system and control environment sufficient to determine the audit approach for grants and income received for specific purposes;
- b) assessing the adequacy of controls and compliance testing to confirm that they have operated during the period under review;
- c) identifying all material grants and income received during the year and ensuring that they are appropriately identified within separate income codes;
- d) reviewing the specific terms and conditions of funding to ensure that the expenditure is in accordance with any conditions attached;
- e) on a sample basis, performing detailed testing of expenditure to primary records to confirm

that such funds have been used for the purposes provided;

- f) ensuring that income is separately identified where it is received in one year but not utilised until subsequent years. When funding is utilised in subsequent years, the relevant expenditure should be identified so that appropriate testing can be undertaken;
- g) external auditors should seek to place reliance on the assurance provided by the internal auditor. Where this is done, a review of the specific work supporting that assurance should be carried out;
- h) internal audit plans should include coverage of those systems underpinning the application of 'funds for the purpose'. External and internal auditors should liaise on an annual basis to coordinate the audit strategy for 'funds for the purpose'; and
- i) appropriate evidence should be retained of audit work on 'funds for the purpose'.

REPORTING

8 As part of their opinion on the financial statements, the external auditor must report whether funds from the HEFCW and other sources, administered by the institution for specific purposes, have been properly applied to those purposes and managed in accordance with the Financial Memorandum, relevant legislation

and any other terms and considerations attached to them.

- 9 The overall responsibility for ensuring that funds from the HEFCW and other sources are applied for the purposes for which they were provided rests with the Institution's Governing Body. On an annual basis, the Audit Committee should obtain a report from management specifying the controls established to discharge the Governing Body's responsibility for ensuring that funds received have been properly applied for the purpose. As part of their work, external auditors should review this management report and comment on the consistency of the report with their audit findings and the overall adequacy of the controls in place. This commentary should also indicate what work has been carried out by the external auditor in support of their opinion on 'funds for the purpose'.
- 10 Institutions and their external auditors should have regard to the model set of financial statements for the year ended 31 July 2000 which is included in the Statement of Recommended Practice (SORP).