

Accounts Direction to Higher Education Institutions for 2002-03

To: Heads of Higher Education Institutions in
Wales

Summary: The purpose of the circular is to keep
institutions up to date on the Council's
requirements for the format of their
audited financial statements.

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Further information: Andrew Clark
e-mail: clarka@elwa.org.uk
Telephone: 01443 663 757

Lisa Chappell
e-mail: chappell@elwa.org.uk
Telephone: 01443 663 928

Address: ELWa South East Wales
Ty'r Afon
Bedwas Road
Bedwas
Caerphilly
CF83 8WT

■ INTRODUCTION

The purpose of the circular is to keep institutions up to date on the Council's requirements for the format of their audited financial statements.

■ BACKGROUND

In 2000, the Accounting Standards Board approved a 'Statement of Recommended Practice: Accounting for Further and Higher Education Institutions' (SORP), which was both sponsored and published by the Committee of Vice-Chancellors and Principals, now known as Universities UK.

■ STATUS OF THE SORP

The Council requires all institutions to implement the SORP, or any successor SORP, when preparing their financial statements for accounting periods ending on or after 1 August 2000.

Institutions should note that the four primary accounting statements (income and expenditure account, balance sheet, cash flow statement and statement of recognised gains and losses) must be presented in the formats set out in the 'Casterbridge College' model report and financial statements appended to the SORP. Whilst the remainder of the 'Casterbridge College' example is illustrative, institutions are encouraged to disclose as much of this information as possible.

■ ACCOUNTS DIRECTION FOR 2002-2003

In addition to the requirements of the SORP, the Council requires that institutions' audited financial statements be prepared in accordance with current Accounting Standards issued or adopted by the Accounting Standards Board. In the case of an institution that is also a company limited by guarantee, this direction is subject to the requirements of the Companies Act. Also, institutions are required to:

- 1 include in their financial statements a statement covering the responsibilities of their governing body in relation to corporate governance. The statement is required to indicate how the institution has complied with current best practice in this area. Guidance on how institutions can comply with this requirement is available in Appendix 1.
- 2 disclose the total emoluments of the Vice-Chancellor, Principal or higher paid employees in accordance with Annex A. Higher paid employees are defined as those whose emoluments exceed £50,000. Disclosures should be expressed in bands of £10,000.
- 3 disclose compensation paid or payable to the Vice-chancellor, Principal or any higher paid employee whose annual remuneration exceeds £50,000, in accordance with Annex B.
- 4 ensure that their contracts for external audit make provision for an opinion on whether the institution has applied income, where appropriate, in accordance with the Financial Memorandum, and whether Funding Council grants have been used for the purposes for which they were received. Institutions should be aware that their external auditors will be reviewing the corporate governance statement as part of their audit work and will be including a reference to this work in their audit opinion. An exemplar opinion is available in Annex C. External audit engagement letters should be amended from the model set out in the Audit Code of Practice to allow the auditors to provide this opinion.

This Accounts Direction will remain in force unless institutions are notified otherwise.

Emoluments of the Vice-Chancellor, Principal or higher paid employees

Disclosure requirements:

- 1 A higher paid employee is defined as the Vice-Chancellor, Principal and any employee whose total emoluments during the accounting period under review exceed £50,000.
- 2 Institutions are required to disclose the following in their audited financial statements:
 - the emoluments of the Vice-Chancellor or Principal, disclosing a sub total that excludes the employer's pension contributions and a total that includes these contributions the emoluments of the highest paid employee, if that is not the Vice-Chancellor or Principal
 - emoluments due to a higher paid employee but waived by the employee
 - the salary bands of higher paid employees (including the Vice-Chancellor or Principal), giving the number of such employees that fall into each band. The width of each salary band should be £10,000.
 - the aggregate amount of any compensation paid to any Vice-Chancellor, Principal or higher paid employee for loss of office (see Annex B)
 - the number of employees who have been paid such compensation
- 3 'Emoluments' mean emoluments paid to or receivable by any person for:
 - services to the institution
 - services as a director or officer of any subsidiary of the institution
- 4 For this purpose, 'emoluments' paid to or receivable by an employee include their normal salary, and:
 - fees
 - any expense allowance (to the extent that they are chargeable to UK income tax)
 - employer's pension contributions
 - the estimated money value of any benefits received other than in cash (the money value of benefits in kind should be estimated by reference to the market value of the facility provided)
- 5 Emoluments should not include the employer's national insurance contributions. Compensation for loss of office is a category of payment different from an 'emolument'. Consequently, it should not be included in that person's emoluments for banding purposes.
- 6 If more than one person has been Vice-Chancellor or Principal during the year, each such person's total emoluments for the year must be attributed to that part of the year during which they were Vice-Chancellor or Principal, and these amounts must be disclosed separately.
- 7 Disclosure of the various emoluments should show the analysis between:
 - salaries
 - benefits in kind; and
 - pension contributions

Compensation for Loss of Office

Disclosure requirements:

- 1 The disclosure requirements are detailed below and relate to the Vice-Chancellor, Principal or any higher paid employee whose emoluments exceeded £50,000 in the reporting year and/or in the year immediately preceding the reporting year.
- 2 Institutions shall show the aggregate amount of any compensation paid or payable to the Vice-Chancellor, Principal or any higher paid employee in respect of loss of office.
- 3 This amount disclosed must also include and distinguish between compensation paid or payable for loss of:
 - any other office in connection with the management of the institution's affairs
 - any office in connection with the management of the affairs of a subsidiary undertaking of the institution
- 4 Compensation disclosed shall include the estimated monetary value of any non-cash benefits paid or payable and the disclosure will also describe the nature of such compensation.
- 5 References to compensation for loss of office include compensation paid or payable in consideration for, or in connection with, retirement and/or enhancement of pension scheme benefits.

Guidance on the Suggested Form of wording for the Audit Report by an Institution's External Auditors for the year ended 31 July 2003.

Independent Auditors' Report to the Governing Body of ABC Institution

We have audited the financial statements of ABC Institution for the year ended 31 July 2003 which comprise the Income and Expenditure Account, the Balance Sheet, the Cash Flow Statement, the Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the historical cost convention [as modified by the revaluation of certain fixed assets] and the accounting policies set out therein.

Respective responsibilities of the Governing Body and the Auditors

As described in the Statement of Governing Body's Responsibilities the Governing Body is responsible for the preparation of the Report of the Governing Body and the financial statements in accordance with the Accounts Direction issued by the Higher Education Funding Council for Wales, the Statement of Recommended Practice – Accounting for Further and Higher Education, applicable law and United Kingdom Accounting Standards.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Accounts Direction issued by the Higher Education Funding Council for Wales and the Statement of Recommended Practice – Accounting for Further and Higher Education. We also report to you whether in our opinion, in all material respects, monies expended out of Higher Education Funding Council for Wales 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 all relevant legislation and whether in our opinion, in all material respects, income has been applied in accordance with the financial memorandum with the Higher Education Funding Council for Wales.

We also report to you if, in our opinion, the Governing Body' report is not consistent with the financial statements, if the Institution has not kept proper accounting records, the accounting records do not agree with the financial statements or if we have not received all the information and explanations we require for our audit.

We read the report of the Governing Body including the corporate governance statement and consider the implications for our report if we become aware of any apparent misstatement within it.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board and the Audit Code of Practice issued by the Higher Education Funding Council for Wales. 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 Institution's Governing Body in the preparation of the financial statements and whether the accounting policies are appropriate to the Institution's circumstances, consistently applied and 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 reasonable assurance

that the financial statements are free from material mis-statement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluate the overall adequacy of the presentation of the information in the financial statements.

Opinion

In our opinion:

- a) the financial statements give a true and fair view of the state of the Institution's affairs as at 31 July 2003 and of its surplus of income over expenditure and cash flows for the year then ended, and have been properly prepared in accordance with the Accounts Direction issued by the Higher Education Funding Council for Wales and the Statement of Recommended Practice – Accounting for Further and Higher Education;
- b) in all material respects, monies expended out of Higher Education Funding Council for Wales 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 all relevant legislation;
- c) in all material respects, income has been applied in accordance with the financial memorandum with the Higher Education Funding Council for Wales.

Name
Registered Auditors
Address
Date

Guidance on the statement on corporate governance following the publication of the Turnbull report on the Combined Code

Maintaining a sound system of internal control

- 1 The Governing Body is responsible for the institution's system of internal control. It should set appropriate policies on internal control and seek regular assurance that will enable it to satisfy itself that the system is functioning effectively. The Governing Body must further ensure that the system of internal control is effective in managing risks in the manner which it has approved.
- 2 In determining its policies with regard to internal control, and thereby assessing what constitutes a sound system of internal control in the particular circumstances of the institution, the Governing Body's deliberations should include consideration of the following factors:
 - the nature and extent of the risks facing the institution;
 - the extent and categories of risk which it regards as acceptable for the institution to bear;
 - the likelihood of the risks concerned materialising;
 - the institution's ability to reduce the incidence and impact on the business of risks that do materialise; and
 - the costs of operating particular controls relative to the benefit thereby obtained in managing the related risks.
- 3 It is the role of management to implement the Governing Body's policies on risk and control. In fulfilling its responsibilities, management should identify and evaluate the risks faced by the institution for consideration by the Governing Body and design, operate and monitor a suitable system of internal control which implements the policies adopted by the Governing Body.
- 4 All employees have some responsibility for internal control as part of their accountability for achieving objectives. They, collectively, should have the necessary knowledge, skills, information and authority to establish, operate and monitor the system of internal control. This will require an understanding of the institution, its objectives, the environment in which it operates, and the risks it faces.
- 5 An internal control system encompasses the policies, processes, tasks, behaviours and other aspects of an institution that, taken together:
 - facilitate its effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieving the institution's objectives. This includes the safeguarding of assets from inappropriate use or from loss and fraud, and ensuring that liabilities are identified and managed;
 - help ensure the quality of internal and external reporting. This requires the maintenance of proper records and processes that generate a flow of timely, relevant and reliable information from within and outside the organisation.
 - help ensure compliance with applicable laws and regulations, and also with internal policies with respect to the conduct of business.

- 6 An institution's system of internal control will reflect its control environment which encompasses its organisational structure. The system will include:
- control activities;
 - information and communications processes; and
 - processes for monitoring the continuing effectiveness of the system of internal control.
- 7 The system of internal control should:
- be embedded in the operations of the institution and form part of its culture;
 - be capable of responding quickly to evolving risks to the business arising from factors within the institution and to changes in the higher education sector; and
 - include procedures for reporting immediately to appropriate levels of management any significant control failings or weaknesses that are identified together with details of corrective action being undertaken.
- 8 A sound system of internal control reduces, but cannot eliminate, the possibility of poor judgement in decision-making; human error; control processes being deliberately circumvented by employees and others; management overriding controls; and the occurrence of unforeseeable circumstances.
- 9 A sound system of internal control therefore provides reasonable, but not absolute, assurance that an institution will not be hindered in achieving its business objectives, or in the orderly and legitimate conduct of its business, by circumstances which may reasonably be foreseen. A system of internal control cannot, however, provide protection with certainty against an institution failing to meet its objectives or all material errors, losses, fraud, or breaches of laws or regulations.

Reviewing the effectiveness of internal control

- 10 Reviewing the effectiveness of internal control is an essential part of the Governing Body's responsibilities. The Governing Body will need to form its own view on effectiveness after due and careful enquiry based on the information and assurances provided to it. Management is accountable to the Governing Body for monitoring the system of internal control and for providing assurance to the Governing Body that it has done so.
- 11 The role of institutional committees in the review process, including that of the audit committee, is for the Governing Body to decide and will depend upon factors such as the nature of the significant risks that the institution faces. To the extent that designated Governing Body committees carry out, on behalf of the Governing Body, tasks that are attributed in this guidance document to the Governing Body, the results of the relevant committees' work should be reported to, and considered by, the Governing Body. The Governing Body takes responsibility for the disclosure on internal control in the annual report and accounts.
- 12 Effective monitoring on a continuous basis is an essential component of a sound system of internal control. The Governing Body cannot, however, rely solely on the embedded monitoring processes within the institution to discharge its responsibilities. It should regularly receive and review reports on internal control. In addition, the Governing Body should undertake an annual assessment for the purposes of making its public statement on internal control to ensure that it has considered all significant aspects of internal control for the institution for the year under review and up to the date of approval of the annual report and accounts.

- 13 The reference to 'all controls' in Code Provision D.2.1 should not be taken to mean that the effectiveness of every internal control (including controls designed to manage immaterial risks) should be subject to review by the Governing Body. Rather it means that, for the purposes of this guidance, internal controls considered by the Governing Body should include all types of controls including those of an operational and compliance nature, as well as internal financial controls.
- 14 The Governing Body should define the process to be adopted for its review of the effectiveness of internal control. This should encompass both the scope and frequency of the reports it receives and reviews during the year, and also the process for its annual assessment, such that it will be provided with sound, appropriately documented, support for its statement on internal control in the institution's annual report and accounts.
- 15 The reports from management to the Governing Body should, in relation to the areas covered by them, provide a balanced assessment of the significant risks and the effectiveness of the system of internal control in managing those risks. Any significant control failings or weaknesses identified should be discussed in the reports, including the impact that they have had, could have had, or may have, on the institution and the actions being taken to rectify them. It is essential that there be openness of communication by management with the Governing Body on matters relating to risk and control.
- 16 When reviewing reports during the year, the Governing Body should:
- consider what are the significant risks and assess how they have been identified, evaluated and managed;
 - assess the effectiveness of the related system of internal control in managing the significant risks, having regard, in particular, to any significant failings or weaknesses in internal control that have been reported;
 - consider whether necessary actions are being taken promptly to remedy any significant failings or weaknesses; and
 - consider whether the findings indicate a need for more extensive monitoring of the system of internal control.
- 17 Additionally, the Governing Body should undertake an annual assessment for the purpose of making its public statement on internal control. The assessment should consider issues dealt with in reports reviewed by it during the year together with any additional information necessary to ensure that the Governing Body has taken account of all significant aspects of internal control for the institution for the year under review and up to the date of approval of the annual report and accounts.
- 18 The Governing Body's annual assessment should, in particular, consider:
- the changes since the last annual assessment in the nature and extent of significant risks, and the institution's ability to respond to changes in its business and the external environment;
 - the scope and quality of management's ongoing monitoring of risks and of the system of internal control, and, where applicable, the work of its internal audit function and other providers of assurance;
 - the extent and frequency of the communication of the results of the monitoring to the Governing Body (or Governing Body's committee(s)) which enables it to build up a cumulative assessment of the state of control in the institution and the effectiveness with which risk is being managed;

- the incidence of significant control failings or weaknesses that have been identified at any time during the period and the extent to which they have resulted in unforeseen outcomes or contingencies that have had, could have had, or may in the future have, a material impact on the institution's financial performance or condition; and
 - the effectiveness of the institution's public reporting processes.
- 19 Should the Governing Body become aware at any time of a significant failing or weakness in internal control it should determine how the failing or weakness arose and re-assess the effectiveness of management's ongoing processes for designing, operating and monitoring the system of internal control.

The Governing Body's statement of internal control

- 20 In its narrative statement of how the institution has applied Code principle D.2, the Governing Body should, as a minimum, disclose that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the institution, that it has been in place for the year under review and up to the date of approval of the annual report and accounts, that it is regularly reviewed by the Governing Body and accords with the Turnbull guidance.
- 21 The Governing Body may wish to provide additional information in the annual report and accounts to assist understanding of the institution's risk management processes and system of internal control.
- 22 The disclosure relating to the application of principle D.2 should include an acknowledgement by the Governing Body that it is responsible for the institution's system of internal control and for reviewing its effectiveness. It should also explain that such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss.
- 23 In relation to Code provision D.2.1, the Governing Body should summarise the process it (where applicable, through its committees) has applied in reviewing the effectiveness of the system of internal control. It should also disclose the process it has applied to deal with material internal control aspects of any significant problems disclosed in the annual report and accounts.
- 24 Where a Governing Body cannot make one or more of the disclosures in paragraphs 5.20 and 5.23, it should state this fact and provide an explanation.
- 25 The Governing Body should ensure that its disclosures provide meaningful, high-level information and do not give a misleading impression.
- 26 Where material joint ventures and associates have not been dealt with as part of the group for the purposes of applying this guidance, this should be disclosed.

TIMETABLE FOR IMPLEMENTATION

- 27 The nature of the disclosures that an institution will be able to make on internal control will depend on the extent to which it has established the procedures necessary to implement the Turnbull guidance.

- 28 Once an institution is satisfied it has adopted the final guidance in full, it can make a full disclosure in its financial statements. (A possible statement is shown at Annex A). All institutions must be in a position to make a full compliance statement by 31st July 2003.

Appendix 1 - Annex A**CORPORATE GOVERNANCE STATEMENT**

The College is committed to exhibiting best practice in all aspects of corporate governance. This summary describes the manner in which the College has applied the principles set out in Section 1 of the Combined Code on Corporate Governance issued by the London Stock Exchange in June 1998. Its purpose is to help the reader of the financial statements understand how the principles have been applied.

The College's Governing Body is responsible for the College's system of internal control and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

The Governing Body is of the view that there is an ongoing process for identifying, evaluating and managing the university's significant risks, that it has been in place for the year ended 31 July 2003 and up to the date of approval of the annual report and accounts, that it is regularly reviewed by the Governing Body and that it accords with the internal control guidance for directors on the Combined Code as amended by the British Universities Finance Directors Group.

The College's Governing Body meets six times a year and has several committees, including Strategic Planning Committee, a Resources Committee, a Finance Committee, a Membership Committee, a Remuneration Committee and an Audit Committee. All of these Committees are formally constituted with terms of reference. With the exception of the Strategic Planning and Resources Committee, they comprise mainly lay members of the Governing Body, one of whom is the Chair.

In respect of its strategic and development responsibilities, the Governing Body receives recommendations and advice from the Strategic Planning and Resources Committee, a joint committee of the Governing Body and of the Senate, the body responsible for the College's academic affairs. This Committee's membership includes four lay members appointed by the Governing Body from amongst its members.

The Finance Committee inter alia recommends to the Governing Body the University's annual revenue and capital budgets and monitors performance in relation to the approved budgets.

The Membership Committee considers nominations for co-opted vacancies in the Governing Body membership under the relevant Statute. A majority of lay members are appointed by external bodies, including the Privy Council. Those lay members are eligible for re-appointment by the relevant bodies when they retire by rotation.

The Remuneration Committee determines the remuneration of the most senior staff, including the Vice-Chancellor.

The Audit Committee meets three times a year, with the College's external and internal auditors in attendance. The Committee considers detailed reports together with recommendations for the improvement of the College's systems of internal control and management's responses and implementation plans. It also receives and considers reports from the Higher Education Funding Council for England as they affect the College's business and monitors adherence to the regulatory requirements. Whilst senior executives attend meetings of the Audit Committee as necessary, they are not members of the Committee and once a year the Committee meets the External Auditors on their own for independent discussions.

The senior management team receives reports setting out key performance and risk indicators and considers possible control issues brought to their attention by early warning mechanisms which are embedded within the operational units and reinforced by risk awareness training. The senior management team and the Audit Committee also receive regular reports from the internal audit and 'health, safety and environmental monitoring' functions which include recommendations for improvement. The Audit Committee's role in this area is confined to a high level review of the arrangements for internal financial control. The Governing Body's agenda includes a regular item for consideration of risk and control and receives reports thereon from the senior management team and the Audit Committee. The emphasis is on obtaining the relevant degree of assurance and not merely reporting by exception. At its October 2003 meeting, the Governing Body carried out the annual assessment for the year ended 31 July 2003 by considering documentation from the senior management team and internal audit, and taking account of events since 31 July 2003.

Following the shortfall in recruitment 1999, which is discussed in the Member's Report on page y, a full investigation was performed by a team led by the Registrar. The resulting report was considered by the College's Governing Body. This has resulted in an enhanced advertising campaign and increased awareness amongst staff of the importance of efficient and effective recruitment procedures. The risk of such an unexpected shortfall in the future is thereby reduced.