



# Monitoring External Auditors

A guide for Higher  
Education Institutions

# Monitoring External Auditors

The audit committee of every HEI must formally review the work of the external auditor on an annual basis. The Audit Code of Practice states that the audit committee should agree appropriate performance measures for its external auditors and monitor their performance annually.

There is little in the HE sector to enable a formal and structured review to be conducted.

Building on HEFCE's guidance on 'Audit service performance measures' the Audit Code of Practice (ACOP), the Smith Report, ICAEW publications and best practice from the private and public sectors, BDO Stoy Hayward's education unit has set out a framework to assist in such reviews. An assessment form is enclosed with this bulletin, and further copies are available upon request.

This framework should be adapted to meet the circumstances of each institution and applied in a manner appropriate to them. It should provide a useful starting point.

Although the audit committee must carry out the review itself, it would be appropriate for senior management to give feedback to the committee in all areas of their interaction with the external auditors.

## Audit Committees:

- have primary responsibility for making a recommendation on the appointment, reappointment and removal of external auditors
- should assess the qualification, expertise and resources, effectiveness and independence of the external auditors annually.

In the annual review of the external auditors, the audit committee should be looking at ways to improve the effectiveness and quality of audit and the relationship between the committee, management and the auditors. It should be a constructive and stimulating challenge from which both parties can learn and improve.

The audit committee should oversee the appraisal of the auditor and present the results to the board. The committee should actively seek views from management and try to eliminate any management bias. 'Difficult' or strained relationships with auditors can arise for a number of reasons – these should be thoroughly investigated.

The auditors should be able to privately communicate with the committee, independent of management, and the opportunity should be given for this at every meeting. The committee needs to engage with the institution's auditors and have an open and honest relationship to best benefit from their advice.

The relationship between the committee and the external auditors will commonly cover:

- external audit
- reporting on corporate governance
- reporting to the HEFCE and other regulatory (funding) bodies.

If performance criteria have been set, they should be documented and agreed to remove uncertainty and the risk of misunderstanding. Criteria should be balanced and appropriate, challenging and achievable. Some criteria will be readily assessed, such as meeting agreed deadlines, most will be qualitative. It would be unusual for the external auditors to provide a wide range of 'other services' to the institution as to do so might raise a question over their independence and objectivity. Auditors should not be providing any but de-minimus non-audit services without the express knowledge and agreement of the audit committee.

The five main areas to be considered are:

- qualification
- expertise and resources
- effectiveness
- independence
- leadership.

## Qualification

Qualification of an audit firm should not be an issue. The qualifications required for external auditors of HE corporations are set out in paragraph 59(b) of Schedule 8 of the Further and Higher Education Act 1992. For other HEIs, the requirements are the same as under the Companies Act 1985.

The firm will be a 'registered auditor' and required to comply with audit regulations covering areas such as:

- independence
- integrity
- conflicts of interest
- maintaining professional competence
- compliance with technical standards.

Asking for details of how the firm acts in each of these areas, though perhaps interesting in itself, is unlikely to add significantly to the committee's understanding of the auditor. All firms will be professionally bound to have systems in place.

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Qualifications of the team shall also be considered at a more local level. The audit 'engagement' partner must be a 'Responsible Individual' under the regulations. A Responsible Individual is one able to sign off the audit report (see leadership below). The other members of the team will be a mix of qualified staff and those under training contract. The audit team may include specialists from other disciplines (tax, computer audit, risk assurance).

#### Questions to ask:

- Who are the key members of the audit team?
- What are their qualifications?
- Are there any issues over the designation of the audit engagement partner as a Responsible Individual?
- Are there any issues concerning the firm's status as a Registered Auditor?

## Expertise and resources

Expertise runs at two levels, the expertise (competence) of a firm as a whole and the expertise of individuals within the firm. A firm may have a long list of HE clients 'demonstrating' sector experience; of more relevance will be the audit team's personal experience in HE and other relevant sectors and the resources that they are able to call upon.

As professional practices, all firms will have systems in place to ensure overall compliance and quality. Qualified individuals have a duty to carry out sufficient continuing professional development in their area(s) of expertise. Details of systems and assurance frameworks in these areas are unlikely to greatly inform the audit committee. Far more pertinent is the quality of the people on the audit, their effectiveness and the relationship built with the audit committee.

At partner level, firms will rotate partners in order to comply with ethical pronouncements. ACOP itself determines partner rotation after five years but market testing after seven years.

Continuity of the whole team has advantages in eliminating much of the 'learning curve' and improving efficiency, longer term though it can potentially affect objectivity.

A firm, and particularly a team, with significant 'relevant experience' may find itself stretched at key points in the audit. A partner/team with a number of HEIs will have the same deadlines to meet for each of them. 'Infilling' with non-specialist staff may be appropriate in some sectors, HEIs have specific reporting requirements (financial memorandum and SORP) and an understanding of the environment and accounting framework is often felt preferable.

Some firms run a system of national experts 'shipped in' to deal with problems. Others run through local 'expert teams'. Whichever way it is run, your audit team should be assessed on what they have done and the expertise demonstrable to the HEI.

#### Questions to ask:

- How do you rate the quality of the audit partner and audit staff from a technical accounting and auditing perspective?
- Have they added value through the application of industry knowledge and specialist technical expertise?
- Who was actually involved (partner and staff) and what level of input did they have in the audit, particularly at critical times (and how does this compare to the audit plan/tender)?
- Was the team of the right quality and expertise, working efficiently and effectively?
- Were issues raised at the right time, by the appropriate level of audit staff, with the appropriate level of the institution's staff?
- How focused and relevant are the firm's audit procedures?
- Is there planned and actual continuity of partners and audit staff (taking into account arrangements for partner rotation after five years)?

## Effectiveness

Effectiveness is difficult to measure in isolation. An unqualified audit report may be considered effective by the audit committee but flawed from an audit perspective. Each firm will set out to comply with auditing standards and relevant rules, regulations and statute. Each will develop their own audit methodology and approach. The audit opinion will be given after the methodology has been applied, and other procedural arrangements (review, quality control, quality assurance) have also been applied.

The Smith Report (for listed companies) states that audit committees should 'obtain a report on the firm's own internal quality control procedures'. The international standard of auditing (UK and Ireland) ('ISA') 220 'Quality control for audits of historical financial information' sets out the minimum levels for a firm. This level of detail is unlikely to be particularly illuminating at an HEI. Far more telling will be the information reported in compliance with ISA 260 'communication of audit matters with those charged with governance'.

ISA 260 requires communication at the planning stage as well as the completion stage. There needs to be a mutual understanding of the scope of the audit and respective responsibilities. Information should be shared and auditors should provide constructive observations arising from the audit process to the governors. Within the planning a number of matters need to be communicated to the governors. These include, amongst others:

- materiality
- risk
- internal controls

and take account of management's attitude.

Audit findings need to be discussed including:

- expected modifications to the auditor's report
- unadjusted misstatements
- views about qualitative aspects of accounting practices and financial reporting

'Communication' may be verbal or in writing.

The external and internal auditors should aim to ensure their work programmes complement each other to optimise the effectiveness of their services. This must not threaten the independence of the external audit but should derive efficiencies for the HEI and assist the audit committee in carrying out its role.

HEFCE Assurance Service provides periodic reports and annual letters that should be considered in relation to external auditor. Any feedback from the Assurance Service or other external assessor should be properly considered.

### Questions to ask:

- Did the audit partner and senior audit staff have an up to date understanding of the HEI?
- How effective was the focus of the audit work on major issues and did the work deal appropriately with these areas?
- Did the auditors agree the scope and focus of work with the audit committee prior to commencement of the audit?
- Were significant variations to the audit plan discussed and agreed with the audit committee?
- Were discussions timely?
- What recommendations were made for improvements to internal controls and other areas, and were they subsequently found to be useful and appropriate?
- What was the quality of comments and reports on any non-statutory areas, e.g. corporate governance statement, risk management practices?
- Was the work of internal audit used appropriately?
- How effective was the engagement partner, were there any late surprises or changes in view that could have been avoided?
- Were the formal communications with the audit committee of sufficient quality (audit plan, management letter)?
- Did the auditors appear to be unduly influenced by management during the audit?
- Did the auditors communicate with the committee properly and on a timely basis?
- Are there any HEFCE Assurance Service reviews (or other agencies) in the period?
- What are the key issues in such reviews?

## Independence

The audit committee will want to consider the independence of the auditors from the institution. The ICAEW has issued a useful paper on 'Reviewing auditor independence' which covers the principles and provides guidance on specific aspects. These include:

- Did the auditors disclose in writing and discuss as appropriate all relationships that might be thought to bear on the firm's independence and objectivity? Did the auditors confirm their independence and objectivity?
- Where any permitted non-audit services were performed, were the agreed safeguards properly applied?
- If there were any breaches of policy regarding the provision of non-audit services, key audit partner rotation or other aspects of the auditor independence requirements (including company policy) were these communicated to the committee in an appropriate and timely manner?

Independence can be threatened where the audit firm bills significant fees outside of the audit and general taxation. Audit committees should agree a framework for agreeing the nature and extent of additional services. Such a policy should be applied to the firm and not just to the audit engagement partner.

HEIs and Further Education Colleges report under the same SORP. If firms are involved in both further and higher education, the same teams tend to run the client portfolios. How much of the partner's personal portfolio is derived from HEI and FE work (audit and consultancy)? Involvement in the sector will add to credibility and knowledge – a dependency on the income stream can detract from independence and objectivity.

### Questions to ask:

- How much of the partner's personal portfolio (fees and number of clients) is HE/FE?
- Are there conflicts that could prevent the partner, senior audit team or firm from being independent and objective?

## Leadership

A thread running through all the above is leadership. The leadership of the engagement partner can visibly change the effectiveness of an and breadth of commentary on the institution, sector and forthcoming issues.

The committee might ask:

- What is the quality of leadership demonstrated by the audit partner?
- How effective was the implementation of the agreed audit strategy?
- Have decisions by the lead partner or members of the audit team later been overruled by another partner/specialist in the firm?
- How visible is the lead partner to both management and governors?
- Is knowledge transferred appropriately?
- Were there any 'nasty surprises' at the end of the audit which were readily preventable?
- Does the committee look to the lead partner for his/her views?

## Useful documents/references

- Series of publications from the Institute of Chartered Accountants in England & Wales
  - working with your auditors
  - company reporting and audit requirements
  - reviewing auditor independence
  - evaluating your auditors
- Sir Robert Smith's report
- HEFCE audit assurance service guide
- HEFCE Audit Code of Practice.

## Support from BDO Stoy Hayward

If you would like to discuss any aspect of this paper with us, contact **James Aston** MBE, Head of Education Team or **Liz Roberts** Senior Manager on **01372 734300** or your regional education partner as detailed overleaf.

If you would like to benefit from our services and experience in the Education sector, please contact **James Aston** MBE, Head of Education at [james.aston@bdo.co.uk](mailto:james.aston@bdo.co.uk) or your local specialist partner:

<b>James Aston</b>	London/South	<b>01372 734 300</b>
<b>Rob Turton</b>	Midlands/East	<b>0121 352 6200</b>
<b>Richard Brown</b>	North East	<b>0113 244 3839</b>
<b>Julien Rye</b>	North West	<b>0161 817 3700</b>
<b>Neil Craig</b>	Scotland	<b>0141 248 3761</b>
<b>Kim Hayward</b>	South	<b>02380 881 700</b>
<b>Duncan Ashman</b>	South West	<b>0117 934 2843</b>

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<b>Bristol</b> <a href="mailto:paul.jelley@bdo.co.uk">paul.jelley@bdo.co.uk</a> 0117 934 2841	<b>Guildford</b> <a href="mailto:stuart.bosley@bdo.co.uk">stuart.bosley@bdo.co.uk</a> 01483 469 118	<b>Reading</b> <a href="mailto:simon.watson@bdo.co.uk">simon.watson@bdo.co.uk</a> 0118 925 4408
<b>Chelmsford</b> <a href="mailto:gary.miller@bdo.co.uk">gary.miller@bdo.co.uk</a> 01245 504 601	<b>Hatfield</b> <a href="mailto:gary.ives@bdo.co.uk">gary.ives@bdo.co.uk</a> 01707 255 860	<b>Southampton</b> <a href="mailto:kim.hayward@bdo.co.uk">kim.hayward@bdo.co.uk</a> 023 80 35 6004

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