

**Ayr College**  
**Year Ended 31 July 2006**  
**Report to the Board and the Auditor**  
**General for Scotland December 2006**



BDO Stoy Hayward

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# 1 Executive Summary

## Introduction

- The purpose of this report is to highlight and explain key issues arising from our audit of the financial statements of Ayr College ('the College') for the year ended 31<sup>st</sup> July 2006.
- The matters raised in this report, are only those which have come to our attention arising from or relevant to our work that we believe need to be brought to your attention. Our audit work is designed to enable us to form an audit opinion on the financial statements of the College and it should not be relied upon to disclose all irregularities that may exist nor to disclose errors that are not material in relation to the financial statements.
- This report has been prepared solely for the use by the Board of Management of Ayr College and the Auditor General for Scotland.
- We have completed our audit work in respect of the financial statements for the year ended 31 July 2006 and will be issuing an unqualified audit opinion for the year.

## Scope of Work

- The accounting rules and regulations applied to Further Education Colleges are specifically laid out in various documents as discussed in section 3 of this report. We can confirm that the College is in compliance with the regulations and disclosures required to be made in the financial statements in respect of these documents.

## Corporate Governance Arrangements

- The corporate governance statement within the College's financial statements states that the College has been fully compliant with guidance on corporate governance for the year ended 31 July 2006. We identified no issues of concern in relation to fraud and irregularity. We identified two matters where improvements could be made to Corporate Governance procedures and these have been set out in section 5 of the report. These matters do not affect our overall conclusion that in general the College's systems of internal control appear to be adequate.

### **Compliance with Scottish Funding Council ('SFC') Accounts Direction**

- We can confirm in preparing the financial statements the College has complied with the Accounts direction for Scotland's colleges and universities issued under circular SFC/35/2006.

### **Conclusion**

- The audit of Ayr College was performed in accordance with relevant legal and regulatory requirements and with International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Auditor General for Scotland. This report has been issued to College management and will be considered by the Audit Committee.

### **Acknowledgement**

- The 2005/2006 audit process brought us into contact with a number of staff within the College. We wish to place on record our appreciation of the co-operation extended to us by those personnel.

### **Financial performance**

<b>Profitability</b>	The college made a surplus of £353,000 and an historical cost surplus of £458,000 for the year.
<b>Cashflow</b>	There was a net cash inflow of £1.337million during the year.
<b>Balance Sheet</b>	The financial statements show net assets of £11.723million
<b>Forecasts</b>	The Board of Management are forecasting a surplus of £145,000 in the forthcoming year.

## 2 Introduction

### Purpose of Report

- This report has been prepared in connection with our audit of the financial statements of the College for the year ended 31 July 2006. This report summarises the principal matters that have come to our attention during the course of the audit.
- The contents of the report should not be taken as reflecting the view of BDO Stoy Hayward LLP except where explicitly stated as being so. To a certain extent, the content of this report comprises general information which has been provided by, or is based on discussions with, the management of the College. Except to the extent necessary for the purposes of the audit, this information has not been independently verified.
- One of the purposes of this report is to record features of the year's activities, the way they are treated in the financial statements and the comments thereon provided to audit staff by the College's staff.

### Audit Bodies

- The Auditor General, a royal appointment on the nomination of the Scottish Parliament, plays a key role in holding the Scottish public spending bodies to account for the proper, efficient and effective use of public money.
- Audit Scotland is an independent statutory body which was set up in April 2000 to provide assistance and support to the Accounts Commission and to the Auditor General for Scotland in the exercise of their respective functions. The Auditor General is responsible for securing the audit of the Scottish Executive, Further Education Colleges and other public bodies.

- BDO Stoy Hayward LLP was appointed by Audit Scotland as external auditor to Ayr College for 5 years covering the financial years 2001/02 to 2005/06. This report summarises our audit work for 2005/06 and details how the requirements of the Statement of Responsibilities and the Code of Audit Practice have been met by the College and by BDO Stoy Hayward LLP

### College Responsibilities

- The College is publicly accountable for the conduct of business and the stewardship of funds under its control. The College's Board of Management is therefore responsible for:
  - establishing adequate corporate governance procedures;
  - ensuring funds provided by the Scottish Funding Council have been applied in accordance with the Financial Memorandum adopted by Ayr College on 9 November 2005 and any other conditions which the SFC may from time to time prescribe;
  - ensuring that there are appropriate financial and management controls in place to safeguard public funds and funds from other sources;
  - safeguarding the assets of the College and taking reasonable steps to prevent and detect fraud and other irregularities;
  - securing the economical, efficient and effective management of the College's resources and expenditure;
  - maintaining proper accounting records and preparing financial statements.

### **Auditors' Responsibilities and Approach**

- We are required to report to the Board of Management of the College and to the Auditor General for Scotland on the financial statements of the College. Our responsibilities are to:
  - provide an opinion, to the extent required by the relevant authorities, on the financial statements of the College and the regularity of transactions in accordance with standards and guidance issued by the Auditing Practices Board.
  - review and report on, as required by Audit Scotland's Code of Audit Practice, the College's corporate governance arrangements relating to:
    - the College's review of its systems of internal control
    - the prevention and detection of fraud and irregularity
    - standards of conduct, and prevention and detection of corruption
    - its financial position.
  - obtain an understanding of the accounting and internal control systems in place in the College sufficient to allow the audit to be planned and an effective audit approach developed.
- Our audit work is designed to enable us to form an audit opinion on the financial statements of the College and it should not be relied upon to disclose all irregularities that may exist nor to disclose errors that are not material in relation to the financial statements.

### **3 Scope of Work**

- We took reasonable steps to plan and carry out the audit to ensure that the above responsibilities were met and that we complied with the requirements of Audit Scotland's Code of Audit Practice.
- In essence the scope of our work is similar to that applied to a limited company audit, however, the accounting rules and regulations applying to Further Education Colleges are specifically laid down in various documents as detailed below.

#### **Financial Memorandum**

- This memorandum sets out the terms and conditions under which the Scottish Funding Council will make payments to the Board of Management of Colleges of Further Education out of funds made available by the First Minister of Scotland. We can confirm the College fully complies with the terms and conditions of the memorandum.

#### **Accounts Direction**

- In preparing its annual accounts the College is required to comply with the directions of the Scottish Funding Council (SFC). The Accounts Direction is designed to ensure that disclosures in the financial statements of all colleges follow best practice. We can confirm the College's financial statements comply with the Accounts Direction.

#### **Guidance on Audit**

- Audit Scotland's Code of Audit Practice sets down Audit Scotland's requirements for both internal and external audits. In carrying out our audit work we are also required to comply with International Standards on Auditing (UK and Ireland) and to take cognisance of any relevant Practice Notes and other guidance and advice issued by the Auditing Practices Board. We also comply with relevant ethical

standards and guidance issued or adopted by the relevant professional accountancy bodies and any supplementary guidance issued by Audit Scotland.

#### **Statement of Recommended Practice (SORP)**

- The HE/FE SORP board issued the revised SORP effective from 1 August 2003. The SORP combines the requirements of institutions of Further and Higher Education to ensure financial statements are prepared on a consistent basis. We can confirm that the financial statements of the College comply with the SORP.

## 4 Audit Findings

### Preparation of Financial Statements

- The Financial statements and the required working papers were submitted for audit on 30 October 2006, in line with the agreed timetable. The financial statements submitted to us were complete and were accompanied with working papers of good quality.

### Audit Opinion

- We are satisfied that the financial statements of the College present a true and fair view of its financial position as at 31 July 2006. Following approval of the financial statements by the Board of Management on 14 December 2006, we intend to issue an audit report expressing unqualified opinions on (i) the financial statements of the College for the year ended 31 July 2006 and (ii) regularity.

### Financial Performance

#### *Surplus for Period*

- The College made an historic cost surplus of £458,000 in respect of the year ended 31 July 2006 compared to a surplus of £225,000 for the year ended 31 July 2005.
- Net assets at 31 July 2006 are £11,723,000 (31 July 2005: £11,379,000)
- The balance on the income and expenditure account carried forward as at 31 July 2006 is a surplus of £1,601,000 (31 July 2005: surplus £1,143,000).
- The balance on revaluation reserve carried forward as at 31 July 2006 is a surplus of £5,420,000 (31 July 2005: surplus £5,525,000).
- There has been no movement on the restricted reserve in the year. As at 31 July 2006 the balance is £180,000 (31 July 2005 – £180,000)

### *Cash Flow*

- During 2005/2006 the College experienced a net inflow of cash of £1,337,000 (2004/05: inflow of £531,000).

### *Going Concern Basis*

- In preparing the accounts on a going concern basis the Board of Management is satisfied that SFC will provide sufficient funding to enable the College to operate for at least twelve months from 14 December 2006.

### Performance Indicators

- The Scottish Further Education Funding Council's ('SFEFC') financial security campaign was announced in December 2002, its principal objective being that all colleges would report underlying operating surpluses by the end of 2005-06. Financial security is defined as the ability, on a continuing basis, to generate operating surpluses reliably and as planned, and through that accumulate a reasonable level of financial reserve. The college must also generate sufficient cash to finance its operations and meet its liabilities; regular operating surpluses would ensure this.
- Under the terms of the financial memorandum between SFC and the College, it is the responsibility of the governing body "*to ensure that the institution strives to achieve best value from its use of public funds from all sources*". It is intended that the financial performance indicators used by the Funding Council, when set alongside other performance data, will support the college in seeking best value.
- The table below has been produced from the data published by the Funding Council through circular SFC/36/2006 in respect of the Financial Statements as at 31 July 2005. The formulae have then been applied to the 2005/06 Financial Statements.

- As can be seen Ayr College performs favourably in many areas in comparison to other Colleges within their Group (Income base £10m to £15m) and the Sector.

	<u>Ayr College</u> <u>Factor</u> <u>2005-06</u>	<u>Ayr College</u> <u>Factor 2004-</u> <u>05</u>	<u>Group</u> <u>Average</u> <u>Factor</u> <u>2004-05</u>	<u>Sector</u> <u>Average</u> <u>Factor</u> <u>2004-05</u>
Underlying operating surplus/ (deficit) % of total income	1.0%	0.2%	1.6%	1.8%
Operating surplus/ (deficit) % of total income	2.54%	0.9%	0.6%	1.0%
Designated plus I&E reserves % of total income	11.5%	8.9%	1.1%	7.0%
Historical cost surplus/ (deficit) % of total income	3.3%	1.7%	3.4%	8.6%
Current assets: Current liabilities	0.16	0.1	1.1	1.3
Interest Cover	7.7	2.1	1.5	4

### Grant in Aid Funding

- The College achieved its SUMS target for the 2005/06 academic year. The College's WSUMS target was 52,753 against actual SUMS achieved of 53,777. As a result the College will not be liable to refund any amounts received in 2005/06.

### Corporate Governance Framework and Statement

- The Board of Management has three formally constituted committees which have specific terms of reference and act with delegated authority from the Board.
- We reviewed the College's corporate governance arrangements. Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour at the upper levels of the organisation. The college has a responsibility to put in place arrangements for the conduct of its affairs, ensure the legality of activities and transactions and to monitor the adequacy and effectiveness of these arrangements in practice.
- From our review of Corporate Governance arrangements within the College we do not believe the Corporate Governance statement to be misleading or inconsistent with other information made available to us during the audit process. We did however note some areas where operational efficiency could be improved. These have been set out in Section 5 of this report.

### HM Inspectorate of Education

- A review by HM Inspectorate of Education took place in two phases in the weeks beginning 6 February 2006 (*review phase one*) and 18 April 2006 (*follow-through phase*).
- As the state of the College's finances falls outwith the scope of the review carried out by HMIE, the findings documented in their report published 11 August 2006, have no impact upon our intention to issue an audit report expressing unqualified opinions on (i) the

financial statements of the College for the year ended 31 July 2006 and (ii) regularity, nor are they inconsistent with the Corporate Governance statement.

- In response to the action points made in the report, the College undertook a programme of restructuring, which saw three senior posts being made redundant and six new directorships being made.

#### **Corporate Governance work carried out by BDO**

- A review and assessment of the College's corporate governance arrangements was carried out by us. This assessment included a review of the College's committee minutes and completion of a number of standard checklists. The checklists cover issues relating to systems of internal control, arrangements for the prevention and detection of fraud and corruption, standards of conduct, issues of legality and the College's financial position.
- We identified two matters in relation to Corporate Governance during the audit. These have been set out in Section 5 of this report.
- The College, in accordance with the Accounts Direction, has included in its financial statements, a statement covering the responsibilities of the Board of Management in relation to corporate governance.
- Our review of the statement concluded that it complies with guidance and is not inconsistent with other information we are aware of from our audit.

#### **Prevention and detection of Fraud and Corruption**

- The College's arrangements for preventing and detecting fraud and corruption were assessed during the audit. This assessment showed the arrangements to be operating satisfactorily. No frauds were identified by the College in 2005/06.

#### **Review of Internal Audit**

- Internal audit is a key element of the internal control system set up by management. A strong internal audit function is necessary to ensure the continuing effectiveness of the internal control systems established. The College therefore, needs to have in place a properly resourced internal audit service of good quality.
- Internal audit services are provided by Scott Moncreiff. An assessment was made of the adequacy of the internal audit input and it was concluded that we as external auditors were able to place reliance on the work of internal audit. Accordingly we placed some reliance on the work of internal audit from the following reports issued in 2005/2006.
  - **Financial Systems Overview; and**
  - **2004/05 Follow Up Review**

We understand that Scott Moncreiff will issue their annual internal audit report for the year ended 31 July 2006, by 14 December 2006, concluding that the College has a sound framework of control which provides reasonable assurance regarding the effective and efficient achievement of the College's objectives.

#### **Misstatements**

- During the course of our fieldwork, three errors were identified totalling £439k in relation to misallocations in the year between balance sheet accounts. This has been adjusted for by the College to ensure consistency in comparatives as shown in section 7 of this report.
- Outwith the above, our audit work identified total potential audit adjustments, netting to £5k. These have been considered to be immaterial, and therefore we did not request further adjustment to be made to the figures contained in the Financial Statements in respect

of these differences. The differences are shown in Section 8 of this report.

### **Accounting and Internal Control System Weaknesses**

- One internal control systems weakness was identified during the course of our audit requiring notification to the Board of Management. This has been set out in Section 6 of this report

### **Qualitative Aspect of the College's Accounting Practice and Financial Reporting**

- Our overall assessment, based on our work undertaken, is that the financial procedures of the College are adequate to enable annual financial statements to be produced in the prescribed form.

### **Other matters**

The following other matters were noted by us for your attention:

#### **FRS 17 – Retirement Benefits**

- This standard was published in November 2000 introducing significant changes to the way in which colleges should account for defined benefit pension schemes. Full implementation of FRS17 – ‘Retirement Benefits’ is mandatory for 2005/06 year ends. The College participates in the Scottish Teachers Superannuation Scheme and the Strathclyde Pension Fund (‘SPF’) which are defined benefit pension schemes. The schemes are multi-employer schemes where the share of assets and liabilities applicable to each employer cannot be identified on a consistent and reasonable basis. The College has therefore accounted for its pension costs for both schemes on a defined contribution basis as permitted by FRS 17 and the guidance issued by SFC.
- The SPF have recently issued a Funding Strategy statement for consultation. It is envisaged that separate employer rates will be introduced by 2008 at the earliest although a small number of

separate rates may be introduced in 2006. Assets are currently apportioned based on the liability profile though employer assets have been tracked for each employer since 2002. Indications are that the SPF are moving in the same direction as the Lothian Pension Fund and hence towards full defined benefit disclosures. However consensus at a meeting of college representatives, Audit Scotland, SPF Hymans Robertson and the SFC in January 2006 was that the characteristics of the scheme, as presently constituted, enable college representatives to consider using the reduced disclosure requirements available for defined benefit schemes, within the criteria of FRS17.

- The ASB has issued a FRED that sets out proposals to amend the disclosure requirements contained in FRS17. The FRED proposes replacing the disclosures required by FRS17 with those of IAS 19 – ‘Employee Benefits’. Responses were sent to the ASB in September 2006 for consideration.

#### **Early retirement provision**

- Included in the balance sheet is a provision for the cost of providing for enhanced pensions. The College recalculated this early retirement provision using the actuarial tables and guidance issued by SFC. This resulted in a revaluation adjustment in the year of £158,000 which has been charged to the income and expenditure account.

## 5 Corporate governance issues

### Board Member Self Evaluation

#### *Findings*

- Against recommended practice as contained within the "*Guide for College Board Members, 2006*", produced for the Association of Scottish Colleges (ASC) and supported and developed by the Scottish Funding Council (SFC), there have been no self assessment procedures carried out in the year to 31 July 2006.

#### *Recommendation*

- We recommend that the College reviews the above guidance and supports a system of self assessment on a periodic basis.

#### *Management Response*

- The "Guide for College Board Members" was not "supported and developed by the Scottish Funding Council (SFC)" but its development by the Association of Scotland's Colleges (ASC) was supported by SFC. As with all advice circulated by ASC, the notes were intended to be helpful but not prescriptive. The College is considering at present best practice in self-assessment before implementing the most suitable system.

### Register of Interests

#### *Findings*

- From a review of the Register of Interests, four members of the Board of Management have not updated their disclosure forms for at least twelve months as at 31 July 2006. In addition, a senior member of staff with significant financial interest has not yet

completed a disclosure form. This conflicts with the College's control procedures.

#### *Recommendation*

- We recommend that the Secretary to the Board of Management remind board members of their responsibility to disclose any interests on a regular basis.

#### *Management Response*

- Agreed. Clerk to the Board, as advised to you, is updating all Board Members Register of Interests at the same time each year, hence the reason why four were over twelve months at 31 July 2006.

The one missing disclosure form has now been received and is clear. We would suggest that "significant financial interest" is an overstatement.

## **6 Internal control systems weakness**

### **Sales Ledger Receipts**

#### *Findings*

- As identified last year, the college sales ledger contains many entries where cash has not been allocated against specific invoices, as the payments to account received do not match the invoiced amount. This dilutes the usefulness of the aged debtors report with gross invoices being shown in one column and cash received in respect of these invoices shown in different columns.

#### *Recommendation*

- We recommend that the College revisit this issue with the intention of resolving this in due course.

#### *Management Response*

- Cash is allocated to a specific invoice when the invoice is fully paid. A partial allocation on the customer statement would make it more difficult to understand.

## 7 Summary of audit adjustments

		Balance Sheet			Profit and Loss Account		
		Increase in Assets	Decrease in Assets	Net Assets or (Liabilities)	Decrease in Revenue	Increase in Revenue	Net Profit or (Loss)
Profit/Loss per draft accounts							353,000
Net Assets/(Liabilities) per draft accounts				11,723,000			
<b>Journals</b>							
1	Dr	Prepayments and accrued income	151,761				
	Cr	Accruals and deferred income		151,761			
		<b>Being:</b> Restructuring costs posted to prepayments in error					
2	Dr	Other creditors	130,000				
	Cr	Trade creditors		130,000			
		<b>Being:</b> reallocation of provision for negative debtors					
3	Dr	Hardship fund - Accruals	15,460				
	Dr	Bursary fund - Accruals	141,468				
	Cr	Other creditors		156,928			
		<b>Being:</b> reallocation of fund creditors as per last year					
<b>Total</b>		438,689	438,689	-	-	-	-
Adjusted Net Assets/(Liabilities)				11,723,000			
Adjusted Profit/(Loss)							353,000

## 8 Summary of unadjusted errors

Journals			Balance Sheet		Profit & Loss Account	
			Increase in Assets	Decrease in Assets	Decrease in Revenue	Increase in Revenue
1	Dr	Income and expenditure			13,535	
	Cr	Accruals		13,535		
		<b>Being:</b> additional accruals per report run 02.11.06				
2	Dr	Charitable Trust Rentals			12,750	
	Cr	Accruals		12,750		
		<b>Being:</b> Rent per agreement to year end				
3	Dr	Additional rent due for Girvan			3,963	
	Cr	Accruals		3,963		
		<b>Being:</b> additional accrual required per SAC agreement				
4	Dr	Deferred income	13,333			
	Cr	SFC Project - I&E				13,333
		<b>Being:</b> additional accrual required per SAC agreement				
5	Dr	Accruals	928			
	Cr	Wages and salaries				928
		<b>Being:</b> overstated APT&C accrual				
6	Dr	Deferred Income	2,395			
	Cr	Other Grant Income				2,395
		<b>Being:</b> 04/05 and 05/06 income not accounted for in relation Anniesland College				

7	Dr	Childcare income			2,939	
	Cr	FE Childcare creditor		2,939		
		<b>Being:</b>	<i>reallocation of income vired from FE Hardship fund</i>			
8	Dr	Accrued income	101			
	Cr	Catering income				101
		<b>Being:</b>	<i>reallocation of income vired from FE Hardship fund</i>			
9	Dr	Debtors	36,260			
	Cr	Creditors		36,260		
		<b>Being:</b>	<i>Being reallocation of negative debtors on debtors ledger</i>			
10	Dr	Accruals	12,176			
	Cr	Debtors		12,176		
		<b>Being:</b>	<i>Being reallocation for removal of debtors</i>			
11	Dr	Trade Debtors	2,403			
	Cr	Trade Creditors		2,403		
		<b>Being:</b>	<i>Being reallocation of debit balances on creditors ledger.</i>			
12	Dr	Depreciation charge (P&L)			3,234	
	Cr	Acc depn - Equipment		3,234		
		<b>Being:</b>	<i>Being adjustment for additions not depreciated.</i>			
13	Dr	Fixed assets - Equipment	882			
	Dr	Fixed assets - Computers	18,822			
	Cr	Equipment purchase - property				882
	Cr	Computer equipment purchase				18,822
	Dr	Depreciation			4,882	
	Cr	Acc Depn - Equipment		176		
	Cr	Acc Depn - Computers		4,705		
		<b>Being:</b>	<i>Being reallocation of expenses to capitalised items and associated depreciation</i>			

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	87,300	92,142	41,303	36,461
<b>Cumulative effect on Net Assets</b>		<u>(4,842)</u>		
<b>Cumulative effect on Income and Expenditure Account</b>				<u>4,842</u>