

# Stow College Report to the Board and the Auditor General for Scotland

Year ended 31 July 2007



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 Stow College ('the College') for the year ended 31<sup>st</sup> July 2007.
- 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 Stow 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 2007 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 2007. We identified no issues of concern in relation to fraud and irregularity nor did we identify any major errors or weaknesses during our audit. 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/30/2007.

### **Conclusion**

- The audit of the 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 2006/2007 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 £64,000 and an historical cost surplus of £285,000 for the year
<b>Cashflow</b>	There was a net cash inflow of £229,000 during the year.
<b>Balance Sheet</b>	The financial statements show net assets of £7,571,000. The balance on the revaluation reserve carried forward is a surplus of £3,946,000.

## 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 2007. 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 the College for 5 years covering the financial years 2006/07 to 2010/11. This report summarises our audit work for 2006/07 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 from the SFC are used only for the purposes for which they have been given and in accordance with the Financial Memorandum with the SFC 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 which give a true and fair view of the financial position of the College at the year-end and its income and expenditure for the year.

## **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 the requirements of Audit Scotland's Code of Audit Practice (March 2007), regarding 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 (March 2007) 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.
- A revised SORP: Accounting for Further and Higher Education was published in July 2007 and is effective for 2007/08. This reflects changes in accounting standards and in best accounting practice since the 2003 SORP was published. The key changes in the SORP are as follows:
  - The disclosure requirements of *FRS 25 Financial Instruments: disclosure and presentation* & *FRS 29 Financial Instruments : disclosures*, first apply on adoption of *FRS 26 Financial Instruments : measurement*.
  - *FRS 26 Financial Instruments : measurement* will apply to colleges qualifying as listed entities (including those with listed debt in issue) or those institutions adopting fair value accounting.
  - For colleges which do not have listed debt and are not applying fair value accounting in accordance with the Companies Act or *FRS 26*, the relevant parts of *FRS 4: Capital Instruments* remain applicable.
  - The disclosure requirements in respect of *FRS 17 Retirement benefits* has been amended. It now states that the Local Government Pension Scheme (LGPS) is a multi employer scheme where it is normally possible for

individual employers as admitted bodies to identify their share of assets and liabilities. The SORP therefore considers these schemes should be accounted for as defined benefit schemes (provided that the assets and liabilities relating to colleges can be measured on a reliable and consistent basis) and that the exemption which allows accounting on a defined contribution basis is unlikely to apply. However, in the unlikely case that the exemption does apply, the SORP requires that, in addition to the defined contribution disclosures required by FRS 17, colleges should disclose:

- the reason why sufficient information is not available to account for the scheme as a defined benefit scheme;
- the fact that the scheme is a defined benefit scheme but the college is unable to identify its share of the underlying assets and liabilities;
- any available information about the existence of the surplus or deficit in the scheme and the implications of that surplus or deficit for the college.

This may apply to the SPF scheme in 2007/08.



## 4 Audit Findings

### Preparation of Financial Statements

- The financial statements and the required working papers were ready for audit on 1 October 2007 - in line with the agreed timetable.

### 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 2007. Following approval of the financial statements by the Board of Management on 28 November 2007, our audit report expresses unqualified opinions on (i) the financial statements of the College for the year ended 31 July 2007 and (ii) regularity.

### Financial Performance

#### Surplus for Period

- The College made an historic cost surplus of £285,000 in respect of the year ended 31 July 2007 compared to a surplus of £233,000 for the year ended 31 July 2006.
- Net assets at 31 July 2007 are £7,571,000 (31 July 2006: £7,487,000)
- The balance on the income and expenditure account carried forward as at 31 July 2007 is a surplus of £1,464,000 (31 July 2006: £1,179,000).
- The balance on revaluation reserve carried forward as at 31 July 2007 is £3,946,000 (31 July 2006: £4,167,000).

### Cash Flow

- During 2006/07 the College had a net inflow of cash of £229,000 (2005/06: inflow of £726,000).

### 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 28 November 2007.

### 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 overleaf has been produced from the data published by the Funding Council through circular SFC/33/2007 in respect of the Financial Statements as at 31 July 2006. The formulae have then been applied to the 2006/07 Financial Statements.

- As can be seen the College performs relatively favourably in comparison to other Colleges within their Group on balance sheet ratios and is below average on most income and expenditure account ratios (Income base > £10m-£15m) and the Sector.

	<u>Stow</u> <u>College</u> <u>Factor</u> <u>2006-07</u>	<u>Stow</u> <u>College</u> <u>Factor 2005-</u> <u>06</u>	<u>Group</u> <u>Average</u> <u>Factor</u> <u>2005-06</u>	<u>Sector</u> <u>Average</u> <u>Factor</u> <u>2005-06</u>
Underlying operating surplus/ (deficit) % of total income	0.7%	0.8%	1.6%	2.2%
Operating surplus/ (deficit) % of total income	0.5%	0.3%	1.2%	0.8%
Designated plus I&E reserves % of total income	11.2%	9.0%	4.0%	10.5%
Historical cost surplus/ (deficit) % of total income	2.2%	1.8%	2.5%	1.9%
Current assets: Current liabilities	1.7	1.3	1.3	1.3
Interest Cover	3.7	3.2	4.5	3.0

### Grant in Aid Funding

- The College's WSUMS target for 2006/07 was 53,338 and the College has over delivered in relation to the year. As a result the College will not be liable to refund any amounts received in 2007/08.

### Corporate Governance Framework and Statement

- The Board of Management has six 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.

### System of Internal Control

- A review and assessment of the College's corporate governance arrangements was carried out. 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.
- 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 2006/07.

### **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 Wylie & Bisset. 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 a certain amount of reliance was placed on the work of internal audit in the following areas during 2006/2007.
  - Revenue assurance and credit control;
  - Student support funds;
  - Budget process;
  - PAYE & NI compliance;
  - Systems access and data security

In August 2007, Wylie & Bisset issued the internal audit report for the year ended 31 July 2007. This concluded that, the College has an adequate framework of control, based on the systems examined.

### **Misstatements**

- One adjustment in relation to opening balances across the fixed asset categories – fixtures and fittings and computer equipment – was required. The adjustment was made by the finance manager.
- There were no unadjusted misstatements of significance uncovered in the course of our audit work.

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

- One internal control weakness was identified during the course of our audit. This is listed in section 5 along with any remaining weaknesses noted previously by external audit.

### **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.

### **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' was mandatory for 2005/06 year ends. The College participates in the Scottish Teachers Superannuation Scheme ('STSS') and the Strathclyde Pension Fund ('SPF') which are defined benefit pension schemes. All colleges treat the STSS scheme as a defined contribution scheme as there is general agreement that they are unable to identify their share of the scheme's assets and liabilities. The SFC's *Detailed notes for guidance on the completion of 2006-07 financial statements* sets out the treatment of the SPF scheme suggesting it should be treated as a defined contribution scheme. This is discussed further in the paragraph

below. As auditors we concur with the treatment of the two schemes for the year ended 31 July 2007.

- In relation to the SPF scheme it is envisaged that separate employer rates will be introduced by 2008 at the earliest. 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 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.

#### **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 actuarial tables guidance issued by SFC and an appropriate interest rate.

#### **Glasgow City Centre Colleges Project**

- In conjunction with three other colleges in Glasgow, the College is currently working on an estates strategy. The business case for this strategy is still in development. However, any valuations undertaken on the College's estates could indicate the need for impairment in the current carrying values of the College's land and buildings. We discussed this ongoing project with college management and the implication of impairment of the current carrying values having regard to the expected duration of future use. Discussions with regards to this project remain ongoing and there is no indication of impairment at this stage.

#### **Recognition of Income - European Social Fund (ESF)**

- The College is accounting for ESF income in its income and expenditure account by matching income against relevant costs in accordance with its accounting policy. During the course of our audit work we uncovered no breaches of the conditions attached to the ESF claims and we received assurances from management that this was the case.

## 5 Internal control systems weakness

### Findings from 2007 audit process

#### **Observation**

- During the documentation of the purchases payments system, it is noted a cheque log is not maintained.

#### **Issue**

- A record of all computer cheques issued in cheque number sequence should be held in a separate log in order to easily identify any missing cheques.

#### **Recommendation**

- At the time of issuing cheques, a separate record (computerised) is recommended to be maintained. This will ensure that a new cheque run follows in sequence to the last cheque issued. The log should contain the date of the cheque run, the payee, and the cheque numbers that have been issued. This will easily identify any cheques that have been omitted.

#### **Management Response**

- From August 2007 BACS payments have been introduced and this will significantly reduce the amount of computerised cheques being used. We accept the recommendation and will implement a cheque log. This will also assist us with identifying the volume of computerised cheques being issued as the finance department target is to have 95% of payments being made by BACS.

### Recommendations brought forward from 2006 audit

#### **Recommendation**

- Fixed Assets - To ensure efficient management and control of fixed assets, it is recommended that the College maintain a detailed asset register.

#### **Management Response**

- Following the introduction of SUN 5 in August 2007 the implementation of the detailed fixed asset module will commence with a consultancy visit in December to agree module configuration. Thereafter work will commence on entering the historic asset information. Once implemented the register will be maintained on a regular basis.

BDO Stoy Hayward LLP

9 December 2007