Glasgow College of Nautical Studies Report to the Board and the Auditor General for Scotland

Year ended 31 July 2008

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 Glasgow College of Nautical Studies ('the College') for the year ended 31st July 2008.

- 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 use by the Board of Management of Glasgow College of Nautical Studies and the Auditor General for Scotland.

- We have completed our audit work in respect of the financial statements for the year ended 31 July 2008 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 2008. 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/35/2008.

Conclusion

- The audit of Glasgow College of Nautical Studies 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 2007/08 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.

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 2008. 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 Glasgow College of Nautical Studies for 5 years covering the financial years 2006/07 to 2010/11. This report summarises our audit work for 2007/08 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)

- A revised SORP: Accounting for Further and Higher Education was published in July 2007 which was effective for all colleges in 2007/08. The key changes in the SORP which are relevant to the college are as follows:

    - The requirement for an operating and financial review which encompasses an overview of the college's finances and operations and takes account of good practice.

- We can confirm that the financial statements of the College are in general in compliance with the requirements of the 2007 SORP. The following areas, as laid out in the model financial statements, could be further enhanced, in terms of the operating and financial review, by the College during 2008/09:

    - Performance indicators;
    - Treasury policies and objectives;
    - Cash flows and liquidity;
    - Student numbers and achievements;
    - Curriculum developments;
    - Payment performance;
    - Resources;
    - Principal risks and uncertainties
    - Stakeholder relationships

- In addition to the key changes affecting the college the following areas are subject to new emphasis within the revised SORP which affect the college:

    - Component accounting. This is an area which should be borne in mind by college management in the future in light of ongoing development options. College management should ensure future projects are split into constituent parts based on useful economic life and depreciated accordingly.

    - The disclosure requirements in respect of *FRS 17 Retirement Benefits* have 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.

The college has taken the view that it is unable to identify its own share of the underlying assets and liabilities within the SPF scheme on a reliable and consistent basis. As there is no definitive guidance issued by the SFC, the college continues to account for contributions to both of its schemes as if they are defined contribution schemes.

4 Audit Findings

Preparation of Financial Statements

- The financial statements and the required working papers were ready for audit on 22 September 2008, in line with the agreed timetable. The working papers supplied were of a good standard.

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 2008. Following approval of the financial statements by the Board of Management on 4 December 2008 our audit report expresses unqualified opinions on (I) the financial statements of the College for the year ended 31 July 2008 and (ii) regularity.

Financial Commentary

- This section summaries the main financial features and key movements from the prior year.

Income and expenditure account

- The College made a surplus of £342,000, 2.1% of total income (2006/07: £805,000 and 5.1%) in respect of the year ended 31 July 2008. The sector average for 2006/07 was 1.6%.

Income

- Total income increased by £641,000 (4.0%). Significant movements include increases of £618,000 and £196,000 in SFC grants and other operating income, with a reduction in tuition fees and education contracts of £182,000.

- The table below summarises the main sources of income for 2007/08 and 2006/07.

	2007/08	**2006/07**	**2007/08**	**2006/07**
	£'000	**£'000**	**%**	**%**
Scottish Funding Council Grants	7,439	6,821	45%	44%
Tuition Fees and Education Contracts	5,728	5,910	35%	37%
Other Grant Income	322	352	2%	2%
Other Operating Income	2,605	2,409	16%	15%
Investment Income	389	350	2%	2%
Total Income	**16,483**	**15,842**	**100%**	**100%**

- The percentages of total income received from the various sources of income remain relatively consistent with 2006/07. The college is substantially less dependant on SFC Grants than other College's delivering over 40,000 WSUMs. From review of the 2006/07 SFC performance indicators, total SFC grant income is normally in the region of 71% for colleges in this category.

Expenditure

- Total expenditure increased by £1,105,000 (7.3%) in comparison to 2006/07. The most significant movement is in relation to an increase in staff costs of £992,000 (including an FRS 17 adjustment of £309,000).
- The table below summarises the main sources of expenditure for 2007/08 and 2006/07.

	2007/08	**2006/07**	**2007/08**	**2006/07**
	£'000	**£'000**	**%**	**%**
Staff costs	11,076	10,084	69%	68%
Other Operating Expenses	4,392	4,271	27%	28%
Depreciation	659	639	4%	4%
Interest payable	15	43	<1%	<1%
Total Expenditure	**16,142**	**15,037**	**100%**	**100%**

- Proportionately expenditure remains consistent with 2006/07.

Balance sheet

- Net assets at 31 July 2008 are £20,518,000 (31 July 2007: £15,381,000)
- The balance on the income and expenditure account carried forward as at 31 July 2008 is a surplus of £5,330,000 (31 July 2007: £4,744,000).
- The balance on revaluation reserve carried forward as at 31 July 2008 is a surplus of £12,935,000 (31 July 2007: surplus £8,198,000) following the revaluation uplift of land and buildings in the year of £4,981,000.
- The balance on the restricted reserve carried forward as at 31 July 2008 is £171,000 (31 July 2007: £166,000).
- The balance on deferred capital grants carried forward as at 31 July 2008 is £2,082,000 (31 July 2007: £2,273,000).

Cash Flow

- During 2007/08 the College experienced a net inflow of cash of £516,000 (2006/07: inflow of £1,229,000).

Financial Forecasting

- The original budget for 2007-08 forecast an operating surplus for the year of £449k. This was revised to £456k in the Financial Forecast Return 2008. There were various movements on forecast as set out below. Fluctuations in income have been in the main offset by a careful monitoring of costs.

Financial Forecasting

	2007/08
	£'000
2007-08 forecast outturn	456
Decreased SFC grant income	(508)
Increased tuition fees	590
Increased education contracts	66
Increased other income	136
Increased investment income	23
Increased payroll costs	(235)
Increased operating costs	(174)
Increased depreciation	(17)
Decreased interest payable	5
2007/08 actual outturn at 31 July 2008	**342**

- The following table summarises the forecast income, expenditure and cash balances for the College for 2008/09.

	£'000
Income	16,706
Expenditure	16,312
Forecast surplus for the year ending 31 July 2009	394
Cash balance at 31 July 2008	7,116
Forecast movement in cash during 2008/09	703
Resulting cash balance at 31 July 2009	7,819

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 4 December 2008.

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 reserves. 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/44/2008 in respect of the Financial Statements as at 31 July 2007. The formulae have then been applied to the 2007/08 Financial Statements.

- Glasgow College of Nautical Studies performs better than other Colleges within its group (Income base > £15m-£20m) in five of the six performance benchmarks and performs better than the sector average in four of the six.

	GCNS Factor 2007-08	**GCNS Factor 2006-07**	**Group Average Factor 2006-07**	**Sector Average Factor 2006-07**
Underlying operating surplus % of total income	2.1%	5.1%	3.6%	3.3%
Operating surplus % of total income	2.1%	5.1%	1.6%	1.6%
Designated plus I&E reserves % of total income	33.4%	31.0%	17.6%	17.0%
Historical cost surplus/ (deficit) % of total income	3.6%	6.7%	3.2%	4.0%
Current assets: Current liabilities	2.9	2.9	1.4	1.4
Interest Cover	22.8	19.9	4.8	5.0

Corporate Governance Framework and Statement

- The Board of Management has seven 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. One instance of employee theft of cash was identified by management in 2007/08. The amount involved was less than £1,000 and the impact on the College resources was minimal. The employee involved was dismissed by the college and control procedures have been revised to prevent this happening again.

- 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 a certain amount of reliance was placed on the work of internal audit in the following areas during 2007/2008.

  - Student residencies including income generation and accounting
  - Communications strategy
  - Follow up report

In October 2008, Scott Moncreiff issued the internal audit report for the year ended 31 July 2008. This concluded that, the College has an adequate framework of control, based on the systems examined.

Misstatements

- Some balance sheet reallocations were made following our audit work with the net effect on income and expenditure account being nil.

- There were no unadjusted misstatements of any significance uncovered in the course of our audit work.

Accounting and Internal Control System Weaknesses

- There were no internal control systems weaknesses identified during the course of our audit requiring notification to the Board of Management.

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 from 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 debate regarding the appropriate accounting treatment of the Strathclyde Pension Fund has not been resolved to a definitive position. Following a further review the Scottish Funding Council ('SFC') issued its findings and conclusions in a letter dated 17 October 2008. The SFC states that "whilst the arguments are finely balanced regarding the accounting treatment, the direction of travel does appear to be towards accounting for the SPF as a defined benefit scheme". Although the SFC is minded to advise colleges in the SPF to consider the possibility of accounting for the scheme as defined benefit, no directive to this effect is given, and it is acknowledged that there is scope within FRS17, as currently worded, to account for the scheme as defined contribution.

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, guidance issued by SFC and an appropriate interest rate.

New Campus Glasgow Project

- In conjunction with three other colleges in Glasgow, the College is currently working on the New Campus Glasgow project. The business case for this strategy is due to be finalised in December 2008. Any property valuations undertaken on the College's current estates could indicate the need for impairment in the current carrying values of the College's land and buildings. However, as the New Campus Glasgow project is still subject to approval, no impairment provision is required in the year to 31 July 2008.

Financial Outturn

- Audit Scotland and SFC expect close scrutiny of the College's financial forecasting and achievement of the forecast financial outturn for 2007/08. Per the original budget for the year 2007/08 the college anticipated that a surplus of £449k would be achieved. The final outturn per the draft financial statements shows a surplus for the year of £342k. Per the financial forecast return it was anticipated that a surplus of £456k would be achieved.

Recognition of ESF income

- 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 they were unaware of any breaches.

Recoverability of debtors

- Last year, problems with the recovery of debtors were identified by us. Following an examination of this area by management, more robust systems and credit control procedures have been put in place to minimise bad debts.

5 Other Matters

- The Charities and Trustee Investment (Scotland) Act 2005 ("the Act") came into force in April 2006, introducing new duties and responsibilities for the Office of the Scottish Charity Regulator ("OSCR").

All charities, including Scotland's colleges, are required to demonstrate to the Office of the Scottish Charity Regulator (OSCR) that they meet the new charity test, set out the in the Act. In a pilot, on John Wheatley College, OSCR ruled that the college did not meet the charity test because its constitution permits Scottish Ministers to direct or otherwise control its activities. A statutory instrument was laid in parliament in June 2008 which came into force on 27th June 2008. This disapplies the section in the Act in relation to controlling activities, consequently charitable status is maintained.

BDO Stoy Hayward LLP

4 December 2008