



**James Watt College**  
Report to the Board  
and the Auditor General for Scotland

**Year ended 31 July 2009**



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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 James Watt College ('the College') for the year ended 31<sup>st</sup> July 2009.
- 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 James Watt 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 2009 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 2009. 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 James Watt 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 2008/09 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 2009. 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 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 LLP was appointed by Audit Scotland as external auditor to James Watt College for 5 years covering the financial years 2006/07 to 2010/11. This report summarises our audit work for 2008/09 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 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)

- We can confirm that the financial statements of the College, are in general in compliance with the requirements of the 2007 SORP.
- Additional guidance on the content of the operating and financial review (OFR), the inclusion of which is recommended within the 2007 SORP, was issued by the Scottish Funding Council on 2 October 2009. This guidance states that it would be helpful if a core set of performance indicators could be incorporated within the OFR to meet best practice and facilitate comparisons between the performances of different colleges. Two colleges have been identified as providing examples of good practice. The College has included an adequate level of detail within its OFR.
- One of the key areas of emphasis within the 2007 SORP that has had an impact on the College is the College treatment of FRS 17:

This year for the first time the College has elected to account for the Strathclyde Pension Fund (SPF) as a defined benefit fund per FRS 17 as the scheme's actuaries assessed that they were able to identify the College's share of the assets and liabilities on a fair and reasonable basis. This actuarial valuation shows that the College had an FRS 17 pension deficit of £8,180k as at 31 July 2009 which has now been shown as a liability on the balance sheet. The comparative figures have been restated with an FRS 17 liability having been introduced into the balance sheet as at 31 July 2008.

The College is accounting for the Scottish Teachers' Superannuation Scheme (STSS) as if it were a defined contribution scheme. This accounting treatment is consistent with the view taken by the scheme's actuaries.



## 4 Audit Findings

### Preparation of Financial Statements

- The required working papers were ready for audit on 19 October 2009 as per the agreed timetable. The financial statements were made available on Monday 19 October 2009.

### 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 2009. Following approval of the financial statements by the Board of Management on 16 December 2009 our audit report expresses unqualified opinions on (i) the financial statements of the College for the year ended 31 July 2009 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 £251k, 0.6% of total income (2007/08: restated surplus of £913k and 2.44%) in respect of the year ended 31 July 2009. The sector average for 2007/08 was 1.3%.

### *Income*

- Total income increased by £2,092k (5.6%). The increase is primarily due to increases in SFC grant income of £3,807k and a fall in other grant income of £1,630k.
- The increase in SFC grant income in the year was primarily as a result of increased SUMs that were originally going to be delivered. However the College recognised that they would not meet the SUMs target and obtained SFC agreement to realign £1.4m of the grant in

order to meet the costs associated with the restructuring programme undertaken by the College.

- The table below summarises the main sources of income for 2008/09 and 2007/08.

	2008/09	2007/08	2008/09	2007/08
	£'000	£'000	%	%
Scottish Funding Council Grants	32,734	28,927	83%	77%
Tuition Fees and Education Contracts	4,248	4,102	11%	11%
Other grant income	208	1,838	1%	5%
Other operating income	1,761	1,868	4%	5%
Investment Income	538	662	1%	2%
<b>Total Income</b>	<b>39,489</b>	<b>37,397</b>	<b>100%</b>	<b>100%</b>

- A significant proportion of income is received from the Scottish Funding Council and the various sources of income remain relatively consistent with 2007/08. Total Funding Council Grant income is normally in the region of 71%, based on the 2007/08 statistics, for colleges in this category.

### Expenditure

- Total expenditure increased by £2,754k (7.5%) in comparison to 2007/08. The main movement was in relation to exceptional restructuring costs in the year of £1,249k which have been included within staff costs.
- The table below summarises the main sources of expenditure for 2008/09 and 2007/08.

	2008/09	2007/08	2008/09	2007/08
	£'000	£'000	%	%
Staff costs	25,996	23,280	64%	64%
Other Operating Expenditure	10,940	11,289	28%	31%
Depreciation	1,521	1,496	4%	4%
Interest payable	781	419	1%	1%
<b>Total Expenditure</b>	<b>39,238</b>	<b>36,484</b>	<b>100%</b>	<b>100%</b>

### Balance sheet

- Net assets at 31 July 2009 are £12,238k (31 July 2008: £14,264k)
- The balance on the income and expenditure account carried forward as at 31 July 2009 is a surplus of £958k (31 July 2008: deficit of £175k).
- The balance on revaluation reserve carried forward as at 31 July 2009 is a surplus of £14,469k (31 July 2008: surplus £15,034k).
- The balance on deferred capital grants carried forward as at 31 July 2009 is £4,991k (31 July 2008: £3,125k).
- The balance on the pension reserve carried forward as at 31 July 2009 is a deficit of £8,180k (31 July 2008: deficit of £3,720k)

### Cash Flow

- During 2008/2009 the College experienced a net outflow of cash of £5,152k (2007/08: inflow of £4,287k).

### Financial Forecasting

- The 2008-09 financial plan forecast a surplus of £277k. There were various movements on forecast as set out below. Fluctuations in income have been offset by a careful monitoring of costs.

## Financial Forecasting

	2008/09
	£'000
<b>2008-09 forecast outturn</b>	277
Increase in SFC grant income	1,069
Increase in tuition fees and education contracts	354
Reduction in other income	(21)
Reduction in investment income	(273)
Increase in staff costs	(47)
Increase in exceptional restructuring costs	(1,249)
Increase in other operating expenditure	(177)
Reduction in interest paid	318
<b>2008/09 actual outturn at 31 July 2009</b>	251

- The following table summarises the forecast income, expenditure and cash balances for the College for 2009/10.

	£'000
Income	37,679
Expenditure	37,634
<b>Forecast surplus for the year ending 31 July 2010</b>	45
Cash balance at 31 July 2009	6,949
Forecast movement in cash during 2009/10	(809)
<b>Resulting cash balance at 31 July 2010</b>	<u>6,140</u>

College income and expenditure are both expected to decrease in 2009/10. The decrease in income is mainly due to decreased SFC grant income as a result of the strategic realignment coming to an end in 2008/09. The expenditure decreases are primarily down to a reduction in staff costs with no exceptional restructuring costs forecast.

### **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 16 December 2009.

## 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 opposite has been produced from the data published by the Funding Council in respect of the Financial Statements as at 31 July 2008. The formulae have then been applied to the 2008/09 Financial Statements.

	<u>James Watt</u> <u>College</u> <u>Factor 2008-</u> <u>09</u>	<u>James Watt</u> <u>College</u> <u>Factor 2007-</u> <u>08</u>	<u>Group</u> <u>Average</u> <u>Factor</u> <u>2007-08</u>	<u>Sector</u> <u>Average</u> <u>Factor</u> <u>2007-08</u>
Underlying operating surplus/ (deficit) % of total income	0.6%	2.4%	3.1%	2.9%
Operating surplus/ (deficit) % of total income	0.6%	2.4%	1.5%	1.3%
Designated plus I&E reserves % of total income	(0.5%)	(10.4%)	26.5%	22.9%
Historical cost surplus/ (deficit) % of total income	2.1%	4.0%	3.4%	8.9%
Current assets: Current liabilities	1.1	1.1	1.6	1.7
Interest Cover	0.3	2.2	3.6	3.9

### **Grant in Aid Funding**

- The College had a WSUM's target for 2008/09 of 148,800. The college achieved 149,175 WSUM's in 2008/09 and does not anticipate any clawback of grant in aid funding for the year.
- A clawback of £270,475 from 2007/08 was not requested by SFC and is included within creditors in the financial statements.

### **Corporate Governance Framework and Statement**

- The Board of Management has five 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 2008/09.

### **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 were provided by Henderson Loggie for the period to 31 July 2009. 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 2008/2009.
  - Payroll and HR System
  - Business Development Operations
  - Student activity data

In November 2009, Henderson Loggie issued the internal audit report for the year ended 31 July 2009. This concluded that, the

College operates adequate and effective internal control systems as defined in the audit needs assessment.

### **Misstatements**

- Unadjusted misstatements totalling £43,000 were identified during our audit work which would increase the operating surplus of the College. The amounts involved were not deemed to be sufficiently material to warrant adjustment to the financial statements.

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

- No accounting and internal control weaknesses were identified during the course of our audit. In the prior year, several observations were made and to date these have been partially implemented. These are listed in section 5 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.

### **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.

- In relation to the SPF scheme assets are currently apportioned based on the liability profile though employer assets have been tracked for each employer since 2002. The actuaries provided information on the College's interests in the scheme as at 31 July 2009. Management took the view that this information was sufficiently robust for it to account for its participation on a defined benefit basis.

- This was the first period in which the College incorporated the provisions of FRS 17 in the calculation of the pension liability. As the present value of unfunded liabilities of £4,067,000 per the actuarial report was less than the previous early retirement provision of £4,282,000 a prior year adjustment was made to reduce the liability by £215,000 as at 1 August 2007. A further prior year adjustment of £1,008,000 was made to incorporate the overfunding in the funded plans as at 1 August 2007. The 2007/08 financial statements have been restated to incorporate the FRS 17 entries.

- The pension liability calculated with reference to FRS 17 in at 31 July 2009 was £8,180,000 (31 July 2008: £3,720,000).

- The previous early retirement provision is now included within the FRS 17 pension liability, amounting to £4,570,000 of the total as at 31 July 2009.

### **Estates Strategy**

- An Estates Strategy was approved by the Board of Management and the SFC in 2008. There are still ongoing development options being considered by management. The College's accounts for 2008/09 do not reflect any potential impairment of fixed assets which may be considered for replacement as part of the ongoing development options. FRS 11 '*Impairment of fixed assets and goodwill*' requires the carrying value of fixed assets to be equal to the lower of their value in use or recoverable amount, i.e. if sold. The College has considered whether there are any indicators of potential impairment in the carrying value of other buildings in light of ongoing

development plans. From discussions with college management and review of the current status of any capital projects we concur with college management's view that it is too early to determine what, if any, impairment there may be as a result of ongoing development.

### **Financial Outturn**

- Audit Scotland and SFC expect close scrutiny of the College's financial forecasting and achievement of the forecast financial outturn for 2008/09. Per the Financial Forecast return submitted in summer 2008, the surplus projected was £277,000. The actual surplus in the year per the financial statements of £251k is slightly lower than the forecast.

## 5 Internal control systems weakness

### Findings from 2009 audit

- No recommendations have been made in 2009.

### Recommendations made during 2008 audit process

- Two recommendations were made in 2008.

### Fixed Asset Register

#### Observation

- The College does not maintain a detailed fixed asset register.

#### Issue

- It is not possible to identify individual fixed assets in the Excel spreadsheets which make up the asset register.

#### Recommendation

- We would recommend that the College implements a full fixed asset register recording asset numbers, locations and capital grants obtained on the assets. Such a register should enable management to better quantify fixed asset transactions for financial accounting purposes, linking with control of fixed assets in terms of the financial memorandum.

#### Management response in 2008

- *During 2007/08 the College reviewed the timescale for implementing a full fixed asset register and has undertaken to have this complete by December 2009. Progress on this and all other outstanding audit points are monitored through the College Audit Committee which reviews outstanding audit actions at each meeting.*

#### Observation in 2009

- A Fixed Asset Register is in the process of being installed and is due to be operational on 15 December 2009. The new fixed asset register will be reviewed by us as part of next years audit work.

#### Management Response in 2009

- *The Fixed Asset Register will be fully operational by the end of December 2009. Final uploads and checking will be done on the 15 December 2009.*

### Annual declarations of Members Interests

#### Observation

- From a review of the Register of Interests, of the fourteen Board members only thirteen members have returned a declaration form, of which four have not updated their disclosure forms for at least twelve months as at 31 July 2008.

#### Issue

- This conflicts with the College's control procedures.

#### Recommendation

- We recommend the College ensure that all outstanding and out of date annual declarations are signed and dated by the appropriate Board member on completion, and passed to the Clerk to the Board.

#### Management Response in 2008

- *It is the legal obligation of the members of the Board to confirm to the Clerk if there are any changes to their register of interest, members are aware of this obligation. Apart from three new*



*members, who are currently completing their forms, the register is up to date. However, the College has now introduced a regular request for active confirmation by members that registers are not out of date rather than waiting for them to inform the Clerk of any changes. This should be complete by the December 17<sup>th</sup> board meeting.*

#### **Observation in 2009**

- We reviewed the Register of Interests in July 2009 and found that two of the Board members interests had not been updated for at least the past year.

#### **Recommendation**

- We recommend that the Clerk to the Board contacts the relevant members seeking confirmation of their current interests and then updates the register accordingly.

#### **Management Response in 2009**

- *A new Clerk to the Board was appointed in January 2009 who will ensure that confirmation of interests is obtained from all members and that the register is kept up to date going forward.*

## 6 Other Matters

- We have no other matters to report.



**BDO LLP**

16 December 2009